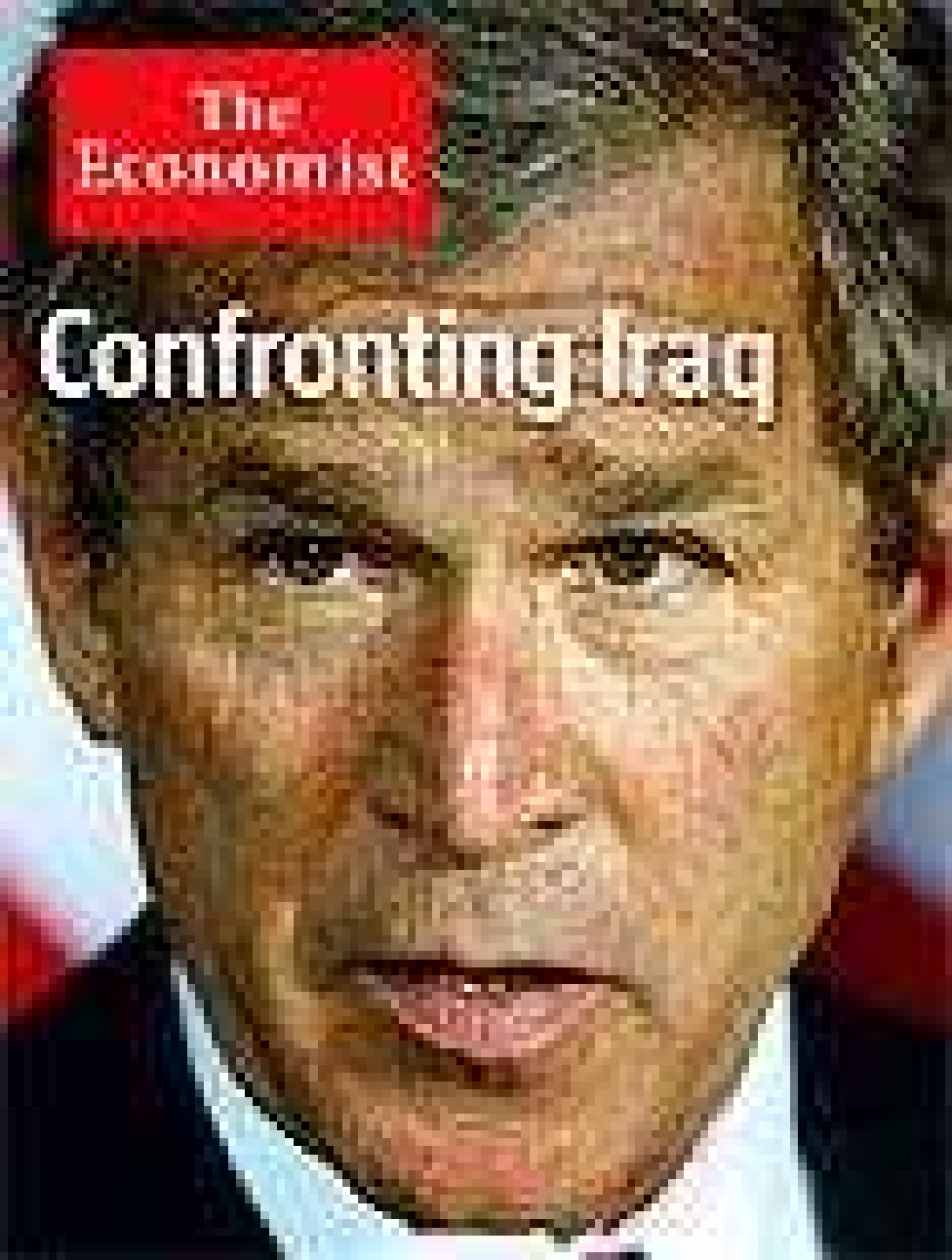
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Confronting Iraq

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Politics this week

Sep 12th 2002
From The Economist print edition

Remembrance and war

AP

Commemorations took place around the world to mark the first anniversary of **September 11th**. At Ground Zero in New York city there was a minute's silence at 8.46am, the moment last year when the first aircraft hit the World Trade Centre. The anniversary was accompanied by warnings of possible further terrorist attacks.

See article: New York's difficult year

Pressure on **Iraq** increased. George Bush met Tony Blair to discuss Saddam Hussein, before going to the United Nations to present his case against the Iraqi dictator. Meanwhile the Pentagon sent 600 members of its Central Command headquarters to the Gulf.

See article: Mr Bush's UN speech

Janet Reno seemed to have narrowly lost the Democratic gubernatorial primary in **Florida**, though the contest was once again marred by problems with voting machines. A local businessman, Bill McBride, will now run against the Republican incumbent, Jeb Bush.

See article: Florida's latest election disaster

In **New Hampshire**, Bob Smith became the first sitting senator to be ejected in a primary since 1992, losing to John Sununu, a young Republican congressman and son of the governor of the same name.

See article: The line-up for the mid-term elections

Not content with passing America's most generous ever **farm bill** a mere four months ago, the Senate voted an additional $6 billion in aid to farmers. The new bill will be a test of Mr Bush's determination to rein in spending.

Lacking confidence

In a blow to **Yasser Arafat's** authority, his cabinet, which he had reformed in June under American pressure, resigned to avoid a parliamentary motion of no confidence. Mr Arafat had earlier announced that elections would be held on January 20th, without, or so he hoped, the disabling obstacles of Israeli closures and curfews.

See article: Rumbles of discontent

Mr Arafat's **Fatah movement** issued a draft declaration that called on all Palestinian organisations to stop attacking Israeli civilians. But members continued to argue over the exact wording.

Ariel Sharon, Israel's prime minister, gave warning that a Lebanese plan to pump water from the **Wazzani river**, a source of the Hasbani river which is shared by the two countries, would be something “Israel could not abide”.

An Israeli army inquiry decided that soldiers who had killed 13 **Palestinian civilians** in three recent incidents had followed correct procedure. An Arab-Israeli accused of assisting a militant Palestinian organisation was stripped of his citizenship.

Al-Jazeera, an Arab satellite-television station, broadcast a videotape said to feature **Osama bin Laden's** voice naming all 19 of the "men who changed the course of history", in other words the terrorists who attacked America last September.

Malawi's parliament, which in July rejected a bill to abolish term limits for the president, is to debate the issue again. President Bakili Muluzi must stand down in 2004 unless the constitution is amended. His government will re-propose the amendment next month.

EPA

In **South Africa**, the constitutional court ruled that gay couples may adopt children. Unlike most other African countries, where homosexuality is abhorred or illegal, South Africa's constitution forbids discrimination.

Zimbabwe's opposition party said that half of its 1,397 candidates for local elections, scheduled for later this month, had been prevented from registering their candidacy, as ruling-party thugs had threatened to kill them.

Going for gold

In **Brazil**, opinion polls showed support for Luiz Inacio Lula da Silva rising to around 40%, giving him a small chance of outright victory in the election on October 6th. Jose Serra, the government candidate, consolidated his grip on second place with around 20%, making a run-off ballot between the two men probable.

Colombia's new government, invoking the state of "internal commotion" decreed last month, gave security forces greater powers of arrest and restriction on freedom of movement. Human-rights groups protested.

Mexico announced its withdrawal from the Rio Pact, a mutual-defence treaty for the Americas dating from the days of the cold war.

Opposition stirred to the proposed **Free-Trade Area of the Americas.** Brazil's Catholic bishops organised a "plebiscite" against it. Venezuela's government promised a referendum on it next year.

See article: Free trade in the Americas

Guns and ballots

Suspected Islamic militants killed 18 people in two separate attacks in Indian-administered **Kashmir**. Among the dead was Kashmir's law minister, Mushtaq Lone. The attacks are thought to be designed to disrupt voting in the state election, due to start on September 16th.

See article: Kashmir's election

At least 100 people were killed when a train **derailed** travelling from Calcutta to Delhi. Over 250 people were injured.

EPA

Pakistani police killed two gunmen and arrested five others after a three-hour shootout in the southern city of Karachi. The men are suspected of being members of al-Qaeda.

Too close to call

All **Germany's** main opinion pollsters put the two main parties competing in the general election on September 22nd neck-and-neck, with the ruling Social Democrats and the conservative Christian Democrats (together with their Bavarian allies in the Christian Social Union) each having about 39%.

See article: Germany's foreign policy

Austria's ruling coalition of mainstream and populist conservatives collapsed after a row within the populist camp. The chancellor, Wolfgang Schüssel, who heads the mainstreamers, said a general election would take place in early December at the latest.

See article: Austria's collapsing government

Vladimir Putin, **Russia's** president, said that his country had a “right to self-defence” if neighbouring Georgia failed to expel rebel Chechens living there, implying that Russian forces might cross the border to attack them.

Though not disavowing its traditional neutrality, **Switzerland** joined the UN as its 190th member.

Flash floods in the south of **France** left 21 people dead and several unaccounted for.

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Business this week

Sep 12th 2002
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De-energised

A cash crisis at **British Energy** sent shares in Britain's privatised nuclear-energy generator into meltdown and reduced the company's credit rating to junk status. The British government reacted by offering £410m ($635m) in loan guarantees to help the ailing power generator stave off bankruptcy while it attempts to restructure its finances.

See article: The near-collapse of Britain's nuclear electricity

British Airways succumbed to competition from low-cost carriers and the post-September 11th troubles of the airline industry. It fell out of the FTSE 100 share index of Britain's biggest companies, for the first time since the airline was privatised in 1987.

Star wars

A space race broke out for **Eutelsat**, the world's fourth-largest satellite company. **PanAmSat** and **Intelsat**, respectively numbers two and three in the business, are after their European rival, although only Intelsat has made a formal bid—of around $4 billion. The victor would rival SES Global of Luxembourg, the world leader in a business dogged by overcapacity.

Jürgen Dormann took over as chief executive of **ABB** on the departure of Jörgen Centerman after 18 months in charge at the troubled Swiss-Swedish engineering group. Mr Dormann, ABB's chairman, said that his strategy of selling assets to concentrate on core businesses could take time to show results, but he also tried to ease fears about debt and the extent of any exposure to asbestos.

A heavily discounted rights issue that will raise £768m ($1.2 billion) for **Legal & General**, a British life insurer, hit shares in other big rivals. Cash to finance growth, claimed L&G, not to plug a hole in the balance sheet. A struggling rival insurer, **Royal & Sun Alliance**, got rid of its chief executive, probably presaging a cash call on investors.

Cutting off MobilCom?

MobilCom suffered a fall of over 50% in its share price in the run-up to a board meeting at France Telecom, which owns 28.5% of the German mobile-phone company. Investors fear that the part-privatised French company will force MobilCom into bankruptcy. France Telecom was also expected to announce a rights issue of *euro*15 billion ($15 billion), and to shed its chairman, Michel Bon.

See article: French bosses' new conservatism

The European Commission gave preliminary assent to a deal that would allow Germany's **T-Mobile** and Britain's **mmO2** to share the cost of building third-generation mobile-phone networks in Britain and Germany. Many more such deals may be in the works as mobile-phone companies seek to recoup some of the $100 billion-plus that they paid for 3G licences during the telecoms boom.

Crown Prince

Citigroup replaced Michael Carpenter as head of Salomon Smith Barney, its investment-banking arm. Charles Prince, a lawyer, took over. Citigroup also announced a new committee to beef up its corporate governance. Regulators investigating Salomon for its practice of allocating shares in initial public offerings to favoured clients and those looking into Citigroup's role in the WorldCom and Enron scandals may feel more action is needed.

See article: Regime-change at Citigroup

An American congressional committee asked the Department of Justice to investigate whether **Martha Stewart** had obstructed justice by lying to prosecutors over allegations of insider dealing. Shares in the lifestyle doyenne's company rebounded handsomely after the news that she had avoided formal charges—for the moment.

See article: Cooking Martha's goose

WorldCom is to replace its chief executive, John Sidgmore. The company's board evidently concluded that the scandal-hit telecoms giant, which went into Chapter 11 bankruptcy in July, needs different managers from those who presided over its fall if it is ever to recover.

See article: Prosecuting America's white-collar crime

Markets remember

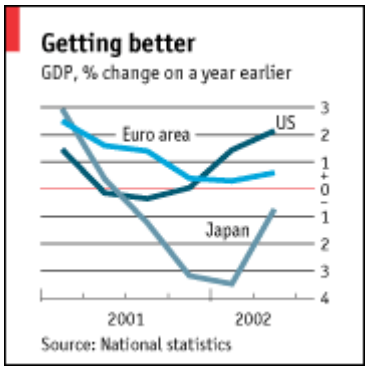
World stockmarkets paused in trading for a moment's silence to commemorate victims on the anniversary of the September 11th terrorist attacks. Wall Street trading began late, after ceremonies to remember the dead.

After a period of quiet, fresh rumours circulated of plans for a **24-hour stock exchange**. Hong Kong Exchanges & Clearing is in talks with the National Association of Securities Dealers to acquire a stake in the American Stock Exchange, America's third-largest exchange.

Going for growth

America's economy seems to be recovering faster than the world's other big economies despite the effects of the September 11th 2001 attacks. Euro-area GDP grew by just 0.6% in the second quarter over a year earlier. Japan's growth for the quarter was revised up slightly, growing by 0.6% over the previous quarter, thus ending a prolonged recession.

See article: Deflation and the world economy



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George Bush at the UN

Confronting Iraq

Sep 12th 2002
From The Economist print edition

Saddam Hussein must be dealt with—by the United Nations if possible, without it if need be

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AP

TO HEAR his many critics tell it, George Bush had serious charges to answer this week before the United Nations court of international opinion. The leader of the free world stands accused of threatening to disrupt international law and order. America's insistence that Iraq be stripped of its illicit weapons of mass destruction, as a matter of urgency, by force if necessary, is anyway surely a ruse, since Mr Bush has publicly admitted his aim is to topple the regime of Saddam Hussein. Although America has called on others to join it, Mr Bush has said he will go it alone if necessary. Such rampant unilateralism undermines the very authority of the United Nations.

The charges are preposterous. Yet Mr Bush had some explaining to do. In a democracy, any leader contemplating going to war has a duty to explain—in Mr Bush's case to Congress and the American people, but also to the wider world—why this needs to be done. His speech to the UN General Assembly on September 12th came too late for *The Economist* to gauge its impact. But whether the world stands with him in dealing with the menace Iraq poses, as he has asked it to, or against him, it is not Mr Bush who needs hauling into the dock, but Iraq's dangerous regime, and those members of the UN Security Council which for years have helped Iraq wriggle out of the disarmament obligations the council itself imposed.

Ends and means

“Not without United Nations approval” is the near-universal chant that has greeted Mr Bush's insistence that doing nothing about Iraq's illicit weapons is no longer an option—as if the Security Council were the moral conscience of the world. Would that it were. It is instead a collection of powerful states, all pursuing their own interests with what one can only hope is a sense of wider responsibility. There was nothing high-minded, for example, about Russia's refusal to countenance military action to halt Slobodan Milosevic's ethnic cleansing of Kosovo. It backed the butcher of the Balkans to the bitter end. Some still claim that NATO's intervention there was illegal, since it lacked explicit UN endorsement. Yet 19 of the world's strongest democracies were surely right to act where the UN, divided, could not.

The case of Iraq is different, admittedly. Saddam Hussein has killed far more of his own people and his neighbours than Mr Milosevic ever did; and he has sent his armies and his rockets well beyond Iraq's borders. The Security Council, at first letting principle triumph over pusillanimity, repeatedly declared him in open breach of his disarmament obligations. What it failed to do was rectify that situation. When it came to the crunch—authorising force to back up the inspectors' right to search out and destroy Iraq's nuclear, chemical and biological stocks—first Russia and China backed off, keen to close all weapons accounts, see UN sanctions lifted and return to oil-business-as-usual. Then France did the same, leaving America and Britain to attempt to hold the line.

The result has been much worse than stalemate: as a report by the International Institute for Strategic Studies points out, Mr Hussein has hung on to his still-hidden arsenal and has had four years free of inspections to restore and conceal as much as he could of what the inspectors had earlier destroyed (see article). To those who, when told that Iraq is a mortal threat to the peace of the world, say “prove it”, the

only sane reply is: what more proof could anyone need?

If it was right to act in Kosovo where the Security Council was stymied, it is surely right to act in Iraq where the council has failed, with potentially disastrous consequences, to deal with what it has accepted itself is an even more potent threat. Then ask yourself, who is undermining the authority of the UN and its Security Council—those who seek to uphold its repeated resolutions on the nuclear, chemical and biological frisking of Iraq, or those who stand in the way?

Credible threats

Yet while it may sometimes, regrettably, be necessary to act without UN approval, isn't America guilty at best of poor judgment, at worst of hypocrisy, in calling not just for inspectors to return to disarm Iraq but for Mr Hussein to be turfed out of power? Won't he be even more tempted to use his horrific weapons rather than see his regime destroyed?

The fact is, it has taken the credible threat of massive force to get Iraq's—and others'—attention. Without it, Mr Hussein would not even be hinting at new inspections (someday, with strings attached). Russia would not now be forced to contemplate how closely to move alongside Mr Bush in order to protect its business dealings in a post-Saddam Iraq. France's president would not this week be reversing himself, to propose a tough new Security Council resolution demanding that Iraq admit inspectors within three weeks, or else (though the “or else” still has no force to it).

If Mr Hussein's only concern were to stay in power, he could have done so by handing over his banned weapons and had sanctions lifted. Instead he has treated inspections as a continuation of the Gulf war by other means. That suggests he has more dangerous plans. It is plausible to conclude that Iraq will not give up its weapons of mass destruction unless he goes. And if he were to surprise the world, and hand them over after all? Then even Mr Bush might conclude that the threat he poses had been suitably deflated.

It is the Security Council's failure to rid Iraq of its weapons of mass destruction, not a gun-slinger's determination to look for trouble, that prompts Mr Bush to insist that America, with others where possible, must finish the job. Yet it is not too late for Russia, China and others who say they want him to work with the UN rather than around it to come up with a properly effective plan for dealing promptly with the threat Iraq's weapons pose. All they have lacked is the will. And for his part, Mr Bush knows that the more international support he can muster, the better, not just to contain and disarm Iraq, but to set the place on its feet properly again once the disarming is done. Why else bother to take his case to the UN at all? But, with or without the UN, disarmed Iraq must be.

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Afghanistan

Securing the peace

Sep 12th 2002
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The international security force should be extended beyond Kabul

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NOT for the first time, some of the rhetoric on the lips of Afghanistan's would-be protectors and rebuilders sounds a bit surreal to ordinary people—both inside and outside that country—who are concerned about its future. As international attention has drifted to a possible next confrontation, with Iraq, officials still trying to rescue Afghanistan from the rubble of 20 years of civil war have found it increasingly hard to squeeze the cash out of some of the governments that just a few months ago had made generous-sounding promises of assistance. Now the Bush administration has reversed itself and declared its active support for the extension of the multinational peacekeeping mission—known as the International Security Assistance Force (ISAF)—from Kabul to other cities.

A commendable idea, people in Kabul might agree—but can the Americans and their allies really mean this? As of now, it is not even certain whether ISAF will remain in the country at all beyond the end of the year. A new UN resolution will be needed, and another country will have to be induced to lead the force when Turkey's mandate expires in December.

Given the steady stream of reports of recent shootings and bombings, the worry of governments, taxpayers and soldiers' families involved in Afghan peacekeeping about extending ISAF will be different. Might America and its friends be about to get bogged down in Afghanistan in a new version of the tragedy which occurred in Somalia in 1992-93, where a multinational operation which started with high ideals ended in an obscure but all too bloody feud?

In fact, the extension of ISAF is more than a good idea. It is probably essential if Afghanistan is to avoid sliding back into the morass of past rivalries. The force has done an excellent job in Kabul, showing how a discreet military presence, patrolling the streets and gathering intelligence, can have a subtle but powerful effect in shoring up a fragile peace. ISAF was not able to avert last week's car bomb; but people in the Afghan capital have generally felt safer—and less likely to be caught up in skirmishing between warlords—than their compatriots in other cities. In places like Mazar-i-Sharif or Herat, the situation is certainly tense and difficult, but not hopeless; a well-planned deployment by ISAF could make all the difference.

Lessons have been learned from other peacekeeping operations, from the Balkans to the Horn of Africa, successes and failures alike. To succeed, such missions need the broad agreement of all local parties who wield a significant amount of force. Afghanistan (or at any rate those places, including all the cities, where the Taliban have been smashed) meets that test. Since the Bonn agreement last December, all the non-Taliban forces have been committed to rebuilding a peaceful, united country with western help.

Peacekeepers must also have enough force to back them up if attacked, but must be capable of reaching out to ordinary people, by dealing with community leaders and assisting in humanitarian work. ISAF has done that in Kabul, and it can do so elsewhere—so long as the ground is prepared by careful intelligence work and local diplomacy. Tension still simmers in the north between leaders of the Uzbeks and the Tajiks—the two ethnic groups which made up the northern alliance. An international force could help keep a lid on violence there.

As everyone now accepts, the cost of allowing Afghanistan to become a “failed state” has been tragically high. That makes the cost of extending ISAF surely worth paying.

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Israel

Crushing Palestine is no answer

Sep 12th 2002
From The Economist print edition

Israel's prime minister and chief of staff seem set on a total victory against occupied Palestine

AP

Get article background

AN END to the Israeli-Palestinian tragedy stretches out of sight, but every so often there comes a chance which, if snatched, might alleviate today's pain. Each time, this chance is muffed. The hope of a ceasefire, or an opening to a less savage situation, is blown away, usually by some brutal deed.

A lull in the violence, encouraging talk of some kind of interim agreement, is smashed, either by a terrorist bomb or by Israel assassinating a militant or raiding the heart of Palestinian territory. Terrorists calculate that they have an interest in maintaining a scary haze of violence. But what about Israel? Some of its leaders, it seems, also doubt that a peaceful respite would be in their best interests.

The latest attempt to break out of the cycle of violence and oppression was the “Bethlehem, Gaza first” plan thought up by Binyamin Ben-Eliezer, Israel's defence minister. In return for the Palestinians cutting down on violence, the Israeli army would relax its restrictions, first in the two named areas, and then elsewhere. The plan has worked in Bethlehem but has yet to be tried in Gaza, let alone anywhere else.

In reply to continued low-level Palestinian violence in Gaza, Israel has twice within two recent days driven its tanks deep into the territory. The unfortunate Mr Ben-Eliezer is trapped, and undermined, by a commanding combination from above and below. Both his prime minister, Ariel Sharon, and his new chief of staff, Lieut-General Moshe Yaalon, have made it plain that they have no time for his plan. Similarly, this week's call, by Yasser Arafat and his Fatah movement, for an end to killing civilians, received a swift brush-off.

General Yaalon has explained, lucidly and at length, the philosophy behind his determination to keep hammering the Palestinians until he gets their unconditional surrender. He is not a political right-winger, as his predecessor was, yet he believes the Palestinians pose a “cancerous” threat to Israel's very existence: they are not, in his view, fighting to end the occupation but to liquidate Israel itself. Israel, therefore, must go for total victory. The Palestinians must be beaten in an unambiguous way that sears into their obstinate minds that they must never try anything against Israel again.

The army has been given its head: its recent killing of 13 Palestinian civilians in three incidents got a quick military whitewash. Worse, the chief of staff opposes any pre-victory deal from which the Palestinians might scent Israeli weakness. Israel's unilateral withdrawal from Lebanon, he argues, was a bad mistake that sent the wrong message to Israel's enemies.

Mr Sharon, who defends General Yaalon as “a level-headed person”, seems to share his views. He insists that Israel should concede nothing in the face of terrorism. That sounds reasonable, but all Palestinians, and some Israelis too, have come to believe that one of his main motives in giving the go-ahead to apparently poorly-timed pre-emptive action is to pre-empt a prolonged ceasefire. This, he fears, might evolve into a situation where he was under pressure to make territorial concessions in return for peace. “Oslo doesn't exist, Camp David doesn't exist, neither does Taba,” said Mr Sharon last week, dismissing the agreements, or attempts to get agreement, that were based on the principle of land for peace.

Without hope

Casting out the land-for-peace equation casts out Palestinian hope. General Yaalon's blanket charge that the Palestinians aim to eliminate Israel distorts the goal of a people living under occupation, most of whom are trying only to win back their land. And loss of hope breeds supporters for the terrorists. Last week, a nervous Israeli public saw a car carrying half a tonne of explosives stopped at a road block. This week, Palestinians were arrested for allegedly trying to poison food.

Such acts are despicable, and Israel has to guard itself against them. But the refusal to deal at all, implicit in General Yaalon's perception of the Palestinians as an enemy only to be flattened, leads directly to an open-ended war of attrition.

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Intellectual property

Imitation v inspiration

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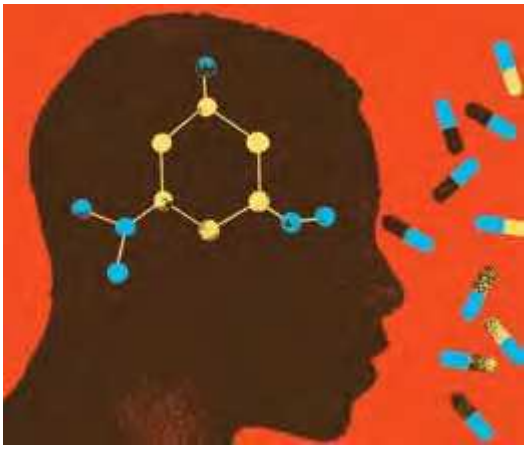
How poor countries can avoid the wrongs of intellectual-property rights



"THE public will learn that patents are artificial stimuli to improvident exertions; that they cheat people by promising what they cannot perform; that they rarely give security to really good inventions, and elevate into importance a number of trifles...no possible good can ever come of a Patent Law, however admirably it may be framed."

Hardly an argument you might expect *The Economist* to endorse. And yet this passage appeared in our pages in 1851. In the mid-19th century, *The Economist* believed that patents hindered rather than helped growth, by restricting the free use of one man's ideas by another. By all means let inventors be rewarded, we argued, but by trying their luck in the open market. Patents, like protection, were an enemy of free trade.

How times change. In today's "knowledge economy", patents seem to be central to western notions of prosperity and international trade. Signing on to the global agreement on intellectual property, called TRIPS, is now part and parcel of membership of the World Trade Organisation.

Most of the world's people live in countries which either do not have, or do not enforce, intellectual-property rights. Not for much longer, however: TRIPS requires even the least-developed countries to have some minimum protection in place by 2006. Whether this is good for the poor is hotly debated. America, which has the most extensive and expensive national-patenting system in the world, preaches that patents help to foster growth in poor places, since they stimulate domestic innovation, boost foreign investment and improve access to new technologies.

Nonsense, retort many poor-country governments. Western-style intellectual-property protection brings many costs and few benefits. Patent systems are expensive to implement, draining scarce money and trained manpower from other more pressing concerns. Patents hurt, rather than help, domestic industries, which are often based more on copying than on innovating. And in the process, western patent rules prevent poor people from getting life-saving drugs, interfere with age-old farming practices and allow foreign "pirates" to raid local biodiversity or traditional handicrafts, without getting permission or paying compensation.

Into this fray now steps a study by an international commission set up by the British government to examine how intellectual-property rights can help or hinder developing countries (see article). It questions the doctrine that patents are good for the poor. There is little evidence to show that truly downtrodden places which introduce robust intellectual-property protection reap any of the much-touted benefits. Certainly, patents matter greatly to some industries, such as pharmaceuticals. But putting in a rigorous patent system will not make Angola a hotspot of biotechnology innovation any time soon; a licence to drive is little use without a car.

For richer, for poorer

Rich countries should remember this when they seek to impose their intellectual-property regime on the rest of the world. It is entirely reasonable for the world's poorest countries to argue that they need until 2016, at least, to adopt and enforce patents on pharmaceuticals. This stay of execution should, indeed,

be extended to all forms of intellectual property. Poor countries should also be wary of any provisions in trade deals that try to impose stronger intellectual-property standards than TRIPS requires, or of any moves towards universal, one-size-fits-all patents in such controversial areas as biotechnology. Rich countries should accept that considerations of how intellectual-property rights affect poor countries are not just a concern of overseas-aid agencies, but play a part in broader trade and economic relations too.

That is not to reject intellectual-property rights in the poor world altogether. Applied in the right way and at the right moment in development, they offer opportunities not threats to poor people. Some developing countries, such as India and China, whose industrial-scale copying of other people's products alarms Western businesses, are sufficiently advanced to support the sort of innovation that would benefit from patents. They should bring their systems up to scratch, for the sake of their own industry. Even the poorest countries can profit from well-designed intellectual-property protection. Senegal, for example, has thousands of musicians who would benefit from copyright enforcement.

Carefully worked-out policies for protecting intellectual property will not solve developing countries' bigger problems, such as inadequate health care, lousy schools and sheer poverty. But if they are adapted to fit individual countries' circumstances, they can play a helpful role in nurturing the domestic industries that lasting growth requires.

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Nuclear power

A dark day in Britain?

Sep 12th 2002
From The Economist print edition

No: the collapse of British Energy is a triumph for energy liberalisation

AS BRITAIN'S privatised nuclear energy generator teeters on the edge of bankruptcy, two ideas are gaining currency. One is that British Energy's collapse, coming as it does on the heels of the recent power crisis in California and the collapse of Enron, proves that electricity deregulation is a failure. The other is that the nuclear industry is unsafe in private hands. Both are wrong.

Britain used to have a “pool” arrangement for electricity trading, which allowed generators (including British Energy) to manipulate prices to boost their profits. That system was recently binned. One consequence is that electricity wholesale prices have fallen by around 40% since 1998, and much of that saving has been passed on to businesses and householders. A second consequence is that it has become clear that there is too much electricity-generating capacity. And a third consequence is that British Energy, which has higher costs than its competitors, can no longer compete. On September 5th, the company announced that it was about to go bust; trading in its shares was suspended; and four days later the government announced a £410m ($635m) rescue package to keep it temporarily afloat.

The idea that British Energy's problems are an indictment of liberalisation is an odd one. A market that used to be rigged by producers to the detriment of consumers is now genuinely competitive. Today's victims are the high-cost generators, not buyers of power. The sharp drop in prices and the excess generating capacity prove that the industry was operating inefficiently, and that consumers were paying too much.

Liberalisation has exposed the true costs of nuclear power, and of the political burdens which the British government has chosen to impose on British Energy (see article). In that sense also, the company's financial problems are a measure of the success, not the failure, of the new trading system. Its openness makes economic inefficiency and political fudge harder to hide.

So what should the government do now? Those who want it to spend more taxpayers' money keeping the company afloat argue that there are two grounds for doing so: nuclear safety and security of supply.

The government certainly needs to ensure that nuclear fuel and waste are handled safely. British Energy is not a widget maker. However, it is perfectly possible for officials to keep fissile materials from Osama bin Laden even if the firm goes bust. The second, and more challenging, test is to keep the lights on. California's blackouts are a poor argument for bailing out British Energy. California never properly liberalised its market—while wholesale prices were allowed to fluctuate, for instance, retail prices were capped. Britain's liberalisation has been far better managed.

If British Energy went under, would the lights go out? No. Were the company to be declared insolvent and go into receivership, any sensible receiver would keep the plants running. And any new owner—if one could be found to take over this dismal prospect for a pittance—would have every incentive to keep cranking out power.

Besides, even in the extremely unlikely event that the firm's plants were shut down tomorrow, there is enough excess generating capacity in Britain to keep the lights on. As that excess fell, wholesale prices would rise. That would cut demand, and encourage generators to revive mothballed plants and increase imports of subsidised nuclear electricity via the interconnector with France.

Anybody want a used nuclear industry?

Since neither the safety nor the supply arguments for spending more taxpayers' money on the company hold water, the government should let it go under. The shareholders will lose their money. That's capitalism. For the future, though, the government should give the nuclear industry a chance to compete by lightening the burden it has placed on the business. British Energy should not, for instance, pay the price of keeping Britain's reprocessing industry going. Nor is the climate-change levy, to which the nuclear industry has to contribute although it generates no carbon dioxide, fairly designed. Nuclear should pay nothing; coal should pay more.

As to who might buy British Energy—what about offering it to France? The poor French taxpayers are so used to having to subsidise their own uneconomic nuclear industry that they might not notice it if they were required to do the same for the British one as well. Worth a try, surely.

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Letters

Sep 12th 2002
From The Economist print edition

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Expanding waste

SIR – You say that the solution to the problem of household waste is to get households to throw less away and that this will happen only if consumers are made to pay directly for the waste they generate ("More rubbish", August 24th). In general, households do not generate waste; they just act as intermediaries between producer and disposer. They do not choose that milk should be sold in disposable packages rather than returnable bottles or that goods come with unnecessary packaging.

Furthermore, the notion that direct payment will reduce waste has been dispelled in Belgium. A swingeing *euro*1.25 ($1.23) charge per 50-litre bag of rubbish has done nothing to stem the tonnage of waste. Germany may well lead in recycling and composting rates but it is also the leader when it comes to mountains of unusable and unwanted "recyclable" material.

Bruce Guy
Brussels

SIR – There is a problem with recycling because manufacturers have too little reason to worry about what happens at the disposal phase. Where reasonably possible they should be made fully responsible for recycling their packaging and products. Only then will materials and methods of construction be chosen to minimise environmental costs at the end. If there is a problem with markets for recycled materials then that should be a problem for manufacturers not local councils.

C. Osman
Aberdeen

Made in Taiwan

SIR – As a citizen of Taiwan, I do not consider myself Chinese. Gong Jianzhong (Letters, August 24th) will find that a significant portion of Taiwan's population agrees with me. I refuse to be mentioned in the same breath as a nation with a pathetic human-rights record, a stubborn, backward and selfish political leadership that refuses to step aside and make way for progress, and a suffering population.

China's plan of "reunification" is based on the premise of financial gain. The Taiwanese leadership has some obvious shortcomings but the difference is that the people of Taiwan have the right and freedom to challenge our leaders without fear of retribution.

George Lin
Sydney

SIR – Mr Jianzhong states that "Taiwan has been an inseparable part of Chinese territory since ancient times." This is a common misrepresentation that China continually pushes on the world's media. Taiwan has had only loose ties with China throughout modern history. The Dutch were the first to colonise the island in 1622. Before that there was little interaction. In 1662, defeated Ming-dynasty loyalists drove out the Dutch in order to use Taiwan as an offshore base to raid the victorious Ching government in China. The Ching (themselves from Manchuria) finally eradicated the Ming rebels and annexed the island in 1683.

Over the next two centuries, the Ching had little interest in Taiwan. It was made a self-governing province in 1887 only in an attempt to ward off preying foreign powers. In 1895, it was readily ceded to Japan as a war reparation. In 1945, the nationalist government of the Republic of China occupied the island and four years later fled there at the conclusion of the Chinese civil war. The Nationalists maintained power in Taiwan until they were defeated in the 2000 presidential election.

Loren Aandahl
Minneapolis

India's liquidity problem

SIR – Your article on water rights in India contains a number of misconceptions ("Nor any drop to drink", August 24th). You correctly refer to the problem of "fuzzy" water rights but then refer to harvesting rain and developing watersheds as means of "extending water rights to people who have traditionally lacked them." In fact, uncontrolled intervention like this, where water is frequently diverted from a legitimate down-stream use, is a classic example of inadequately defined water rights—it is chaotic and unregulated. In Gujarat, a mass programme of "water harvesting" around the city of Rajkot has caused the dam supplying municipal water to dry up.

The water-user associations that you praise are the last thing that will improve water management. First, assess the resource; second, assign water rights; third, define the institutions to administer these rights, which might include water-user associations as a small part of the institutional structure. Starting at the other end of the process, as in Andhra Pradesh, is proving to be a disaster whereby, as you note, the rich and powerful benefit as government agencies withdraw.

Chris Perry
Croyde, Devon

Too many rights?

SIR – Your argument against the Bush administration's restrictions on the rights of suspected terrorists implies that its assessment of the balance between protection of the terrorists' civil liberties and the public's right to liberty from violence has been skewed to favour a "tyranny of the majority" ("A needless victory for terror", August 31st). However, you do not assess the effects that the administration's actions might have had on the probability of additional terrorist attacks.

Terrorists have always banked on slow moving evidentiary procedures in the courts to evade justice. The Bush administration may have saved thousands of lives through its illegal actions, a benefit that more than offsets their illegality or encroachment on civil liberties. American liberalism has always put life first, before liberty and the pursuit of happiness. Americans ought not to die because of die-hard liberal ideology.

Mitchell Langbert
West Shokan, New York

SIR – The main purpose of Hong Kong's anti-terrorism measures is to discharge our international obligations in combating the financing of terrorism. The definition of a "terrorist act" follows the international trend by requiring that such an act must fulfil three conditions ("For whom the Liberty Bell tolls", August 31st). First, there must be the use or threat of action to compel a government or to intimidate the public. Second, the use or threat of action is for the purpose of advancing a political, religious or ideological cause. Third, the act causes serious violence against a person, serious damage to property, creates a serious risk to the health or safety of the public, etc. Actions by individuals or organisations are caught only if they meet all three conditions. Peaceful demonstrations by apolitical organisations will certainly not be affected.

Regina Ip
Secretary for security
Hong Kong

The propaganda battle

SIR – As a non-Arabist satellite surfer, I have found only one channel in the Middle East that is at all

watchable (“Towers of Babelaganda”, August 24th). Its morning show typically has attractive footage of heritage sights and city scenes, bright female presenters, news reports with women and men side by side, outdoor concerts of popular and classical music, and overnight news of the English football scene. Catch it while you can; it comes from Iraq.

Rick Collet
Maidstone, Kent

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Iraq's oil

Don't mention the O-word

Sep 12th 2002
From The Economist print edition

Reuters

If America goes to war against Iraq, what will become of all that oil?

Get article background

AMERICA'S chief interest in going after Iraq's president, Saddam Hussein, is doubtless to save the world from his actual or potential weapons of mass destruction. Another large consideration, secondary as it may be, has attracted less attention than it should have: the effects that would follow from the opening up of the country's enormous reserves of oil.

Iraq's reserves are the second-biggest in the world, after Saudi Arabia's (see table). At present, thanks to UN sanctions and Mr Hussein's attempts to evade them, the country is producing a fraction of its potential. If it were to produce oil at a rate to match its reserves, say some geopolitical strategists, it could end Saudi Arabia's domination of world oil markets.

That would not come too soon for the United States. America is by far the world's biggest oil-user, burning up a quarter of the total consumed. Its imports have risen in recent years, to more than half its total consumption. Since Saudi Arabia is the chief supplier of those imports, successive American presidents have gone to great lengths to cultivate the unsavoury and dictatorial House of Saud. They have also tolerated Saudi Arabia's command of the Organisation of Petroleum Exporting Countries (OPEC), which keeps oil prices much higher than they would be if market forces prevailed. Now America's leaders increasingly feel—as Winston Churchill remarked of converting the British fleet from coal to petroleum before the first world war—that "safety and certainty in oil lie in variety, and variety alone."

Lagging behind 1
Crude oil, at end 2001

	Reserves bn barrels	Production m barrels per day
Saudi Arabia	261.8	8.8
Iraq	112.5	2.4
UAE	97.8	2.4
Kuwait	96.5	2.1
Iran	89.7	3.7
Venezuela	77.7	3.4
Russia	48.6	7.1
United States	30.4	7.7
Libya	29.5	1.4
Mexico	26.9	3.6

Source: BP Statistical Review of World Energy

In hopes of finding such variety, George Bush is now changing American policy. He has openly embraced Vladimir Putin's goal of expanding Russia's oil industry, with talk of increased exports and a big ministerial conference on energy planned for Houston in October. Another opportunity, openly acknowledged or not, is the present showdown with Iraq. Rumours of war are likely to dominate the meeting of OPEC ministers on September 19th in Osaka, in Japan.

The fear premium

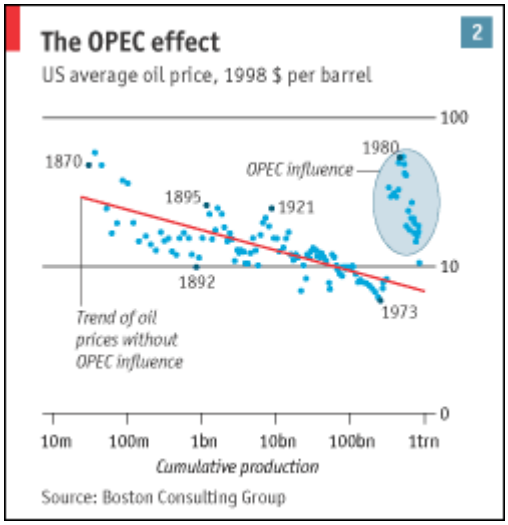
Conventional wisdom says war drums are good news for OPEC and the Saudis today, but bad news in the longer term. Talk of war always heats up the oil price, giving producers an instant windfall. Yet tomorrow, if America succeeds in toppling the bully-boy of Baghdad, the world could be awash in Iraqi oil. Look closer, and matters are more complicated.

In the short term, jittery traders are already handing oil producers a handsome windfall profit. Last week, on ill-founded rumours of a huge air strike by American and British planes in western Iraq, prices shot to their highest level in a year, passing $30 a barrel for West Texas Intermediate, America's benchmark crude. Daniel Yergin, head of Cambridge Energy Research Associates (CERA), an industry consultancy, estimates that the “fear premium” on each barrel of oil is now $3-5.

As war gets closer, prices seem bound to go higher. During the Gulf war, a decade ago, prices spiked past $40 a barrel in nominal terms. Phillip Ellis of the Boston Consulting Group, who has analysed the history of oil shocks and their impact on prices, argues that prices fall into two ranges. The peace curve, as he calls it, “forms around an average of about $22-24 in today's money. The war curve forms around a price north of $50.”

Some would put it higher. Sheikh Zaki Yamani, Saudi Arabia's oil minister during the shocks of the 1970s, gave warning last week that if America invades Iraq, Mr Hussein could attack Saudi Arabia and Kuwait and so send oil prices to $100 a barrel. Iraq's vice-president, Taha Yassin Ramadan, stirred the pot further this week by goading fellow Arabs to strike American targets in the Middle East if Iraq is attacked.

High prices are clearly a nightmare for consumers. Paradoxically, and here is where the complications begin, they are bad news for producers, too. Prices much above Mr Ellis's “normal” range act as a brake on economic growth. There are signs of this happening already, especially in Asia. Some economists worry about an oil-induced global downturn. As the earlier oil shocks have taught OPEC, prolonged periods of high prices only kill the goose that lays the golden egg.



Another reason why sky-high prices are bad for OPEC, and especially for Saudi Arabia, is that they spur oil production from uneconomic places. In a genuinely free market, most of the world's oil would be produced by Saudi Arabia and its neighbours, where the cost of exploration and production is a dollar or two a barrel. In contrast, trying to force drills through rocks in the Arctic or beneath deep water can heap up costs to $10-12 a barrel.

Getting round the Saudis

Because OPEC's “price-defence” strategy has kept prices above $18 a barrel for three years, argues the Petroleum Finance Company (PFC), an industry consultancy, projects in non-OPEC regions—the frozen wilds of Russia, the turbulent Caspian basin, the deep waters of the Gulf of Mexico—have attracted many billions of dollars in investment. High prices have already inspired the development of 2.6m barrels per day (bpd) of non-cartel oil, besides investment in projects that promise to deliver another 5.2m bpd from alternative sources by 2008. This new supply, says the PFC, “has and will continue to eat up all the increase in global demand, leaving OPEC no room to expand its own output and making the cartel's price-defence strategy increasingly difficult to maintain.”

However, the pain is not equally shared among cartel members. It is felt mostly by Saudi Arabia, the self-appointed “swing” producer. That is because higher prices have also encouraged some of the smaller fry in the cartel, such as Nigeria, Algeria and Libya, to develop new production capacity and to bypass existing production quotas set by OPEC. John Mitchell, an energy analyst at Britain's Royal Institute of International Affairs, offers a more fundamental reason to suppose that the cartel's “aggressive collusion” will not endure: the ratio of production to reserves varies greatly among cartel members, and so the incentive to increase output rather than keep it flat also varies greatly.

The result, according to estimates by Deutsche Bank, is that new supply could outstrip expected demand by as much as 1m barrels a day by 2004. The only country that has historically been willing to reduce its own output—and revenue—by such a large volume to “balance” the market and prevent a price collapse is Saudi Arabia.

All this explains why Saudi Arabia has long advocated a moderate stance on prices. Yet when ministers meet in Osaka next week, they face a dilemma. Thanks to fears about war with Iraq, prices are high and the markets are anxious. Winter is on the way, and with it a seasonal upturn in demand for oil. On September 11th the International Energy Agency (IEA), a quasi-governmental watchdog set up by the world's biggest oil consumers, said that stocks of crude were “uncomfortably low” going into the winter, and the whole situation “every bit as precarious” as in 1999, before a notably volatile spell for oil prices.

Reuters

With years of graft and heaps of money, they may be a force again

This being so, the Saudis might argue at Osaka for a modest increase in quotas. On the other hand, as Venezuela and Iran point out, the greatest risk facing the cartel is not high prices but a price collapse. That could happen if OPEC releases oil into a weakening global economy. It did precisely that in the run-up to the Asian economic crisis a few years ago, and oil prices fell to around $10 a barrel.

Even if Saudi Arabia somehow smooths over the meeting in Osaka, some argue, the longer-term picture for the cartel is bleak. The expulsion of Mr Hussein, which looks likelier than not, could turn the oil market upside down. This is because Iraq, with its vast reserves, is the only country that could challenge the Saudis by throwing open the taps.

If a post-Saddam regime did that, Saudi Arabia's strategy of keeping OPEC prices between $22 and $28 a barrel would be under threat. If the flood of Iraqi oil continued indefinitely, goes the argument, the Saudis would have no choice but to abandon price (and, with it, their allies in OPEC with higher costs and smaller reserves) and go for volume instead. Though politically difficult, that need not be economic folly: Deutsche Bank calculates that Saudi Arabia could maintain oil revenues at $60 billion or so either by producing 6m bpd at around $30 a barrel, or by cranking out 10m bpd at about $17 a barrel.

Will the flood of Iraqi oil occur? It is possible. Any future government in Iraq, needing vast amounts of money to rebuild the country, will try to expand the oil sector as fast as it can. At least some oil executives believe that this bonanza could draw much foreign capital into Iraqi oil production. Even if the new government did not break ties with OPEC, as the United States might like, it would probably argue—bearing in mind the years of UN supervision of its oil exports—for a lengthy exemption from quotas.

OPEC, RIP?

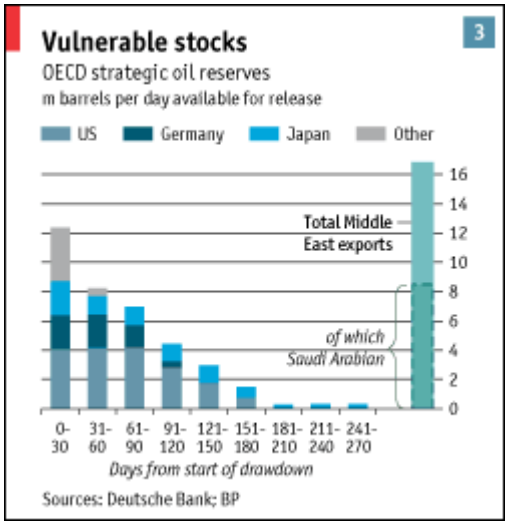
It might seem, then, that knocking out Mr Hussein would kill two birds with one stone: a dangerous dictator would be gone, and with him would go the cartel that for years has manipulated prices, engineered embargoes and otherwise harmed consumers. Yet several factors suggest that the transition to a post-Saddam oil world will be messy—and that such a world could still have a forceful OPEC in it.

Consider again Sheikh Yamani's fear: that Mr Hussein, in a desperate last act, may attack the Saudi and Kuwaiti oil infrastructure and bring the global economy to a halt. The oilfields could be set ablaze, as they were during the Gulf war. Refineries and terminals could be contaminated with radioactive or biological agents. With help from outsiders, Mr Hussein might be able to shut down shipping lanes such as those in the Straits of Hormuz, preventing Saudi Arabia from getting its oil to market.

On balance, though, the risks of a prolonged physical disruption seem small. One senior European oilman insists that it would be very difficult to engineer a complete shutdown of all Middle Eastern oil: “That's a bit like thinking you could shut down all North Sea production by firing SCUD missiles from Germany.” CERA's Mr Yergin says it is difficult to target all the oilfields, pipelines and export terminals that matter in the area. Saudi Arabia has plenty of spare capacity and transport options for its oil; besides, pipelines are pretty quickly patched up.

The world also holds emergency stocks of oil much bigger than

those it held back in the 1970s. These should not inspire complacency; as the chart shows, they cover only a few weeks of disruption, and a prolonged war could still mean disaster. Yet the world at least has the IEA, monitoring oil markets and emergency stocks and engaging OPEC in “consumer-producer dialogues” (another one will take place in Osaka next week) to encourage stable prices. If oil supplies are suddenly threatened, as Robert Priddle, the IEA's boss, explains, governments have even given him the extraordinary power to release oil stocks unilaterally.



Fears of a physical disruption to supply are therefore overblown. More worrying, however, is the possibility that Saudi Arabia will decide it does not want to get extra oil to market. Historically, the Saudis have always acted as the market's guarantor of last resort. During the Iran-Iraq war, for example, they stepped into the breach and increased output to smooth prices. As they intentionally keep a whopping 3m bpd or so of spare capacity to hand, their country alone can easily compensate for the loss of Iraq's current output.

But the Saudis do not like the way the Bush administration is setting about Iraq. The regime also faces great anger on the “street” for its cosiness with the American government. Add to that the Saud dynasty's precarious grip on power, and the ruling family might find it politically impossible to crank up production to help the Americans. The result could be chaos in the world markets, and OPEC left firmly in control.

Another reason to doubt that an invasion would kill off OPEC is the state of Iraq's oil infrastructure. Thanks to a dozen years of UN sanctions, and many more years of mismanagement and over-exploitation, the country's petroleum industry is in pitiful shape. Even in its best times, the country produced only 3m-3.5m bpd: a third of Saudi Arabia's peak and half of Russia's. As one American oil executive says, “Under the very best scenario, Iraq might manage that peak again.” To do better, the country would need massive investment from the world oil industry.

Expect no miracles

That, says the same senior oilman, will be slow in coming until companies are sure that the new regime will be stable and will respect the rule of law. Realistically, experts say, it will take Iraq perhaps five years of hard work, western know-how and big money to turn its oil industry into a serious force again. CERA puts it bluntly: Iraqi output can only increase from today's low levels, but that does not mean “a massive, rapid increase in production that will depress prices, displace other Gulf producers and render OPEC impotent.”

In short, a “regime change” of the sort that Mr Bush has in mind for Iraq might rewrite all the rules of the oil game—on paper. The president's new friendship with Mr Putin also heralds an important change in the geopolitics of energy. In practice, however, the second Bush to take on Mr Hussein will probably be long gone from the White House before the oil markets are transformed by Iraqi oil. Don't write off Saudi Arabia, or OPEC, just yet.

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Iraq's oil exports

Strangled

Sep 12th 2002
From The Economist print edition

The UN gets tougher still

THE mere threat of an invasion is already squeezing Saddam Hussein in at least one way: money. His oil exports, which the UN supervises as part of an oil-for-food scheme, are collapsing. Last year, Iraq exported an average of 1.7m barrels per day (bpd) under the UN programme. Earlier this year, that fell to 1.2m bpd; last week, it was 370,000.

In the past, Mr Hussein has often slashed or raised output to make war noises of his own—suddenly trying to shut off all UN exports, for example, when the Israeli-Palestinian conflict became more deadly, in hopes of inciting a broader Arab oil embargo. Such volatility also gives him leverage with OPEC, as the cartel never knows how much Iraqi oil to expect.

The reasons for the latest decline are different, however. The UN has decided to crack down on Mr Hussein's main way of profiting from his oil. In the past, he managed to persuade middlemen (many of them Russian) to pay an illicit surcharge, direct to him, of around 25 cents a barrel. The UN is trying to cut out those middlemen, and has recently introduced a retroactive pricing scheme: buyers must first commit to a shipment of oil, and will find out only later what price the UN has imposed. This stamps out the surcharge, but few buyers—especially the Americans, once big customers—want to take the risk of buying oil without knowing the final price.

The tyrant is not left destitute. Deutsche Bank estimates that Mr Hussein still manages to export perhaps 400,000 bpd to Jordan, Syria and Turkey via pipeline and lorries; he smuggles some in “tanker caravans” through the Gulf. Such exports are deeply discounted, but still brought him perhaps $2 billion in 2001.

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New York city one year on

A tale of two cities

Sep 12th 2002 | NEW YORK CITY
From The Economist print edition

AP

There is one New York that is recovering well from September 11th—and another New York that probably never will

“BACK to business as usual” was the rallying cry taken up by New Yorkers a year ago, after terrorists destroyed the World Trade Centre. Remarkably, a sort of normality has returned to the city. The first few months after the attack were dreadful, but the new year brought new hope, tourists and businessmen started to return, the hotels and Broadway shows began to fill up. This summer, the city's economy has reportedly resumed growth after a deep recession.

Even so, it would be wrong to conclude that life has returned to normal. New York is not over the terrorist attacks yet, and may never be. It remains consumed with grief for the thousands of lives lost, remembered this week in countless services throughout the city—big and small, private and public. The most moving was the reading of the names of each murdered individual, which came just after one minute's silence was observed at 8.46am on September 11th, the exact anniversary of the first plane hitting the first tower. Can New York ever have been so quiet?

It was a revealing silence, combining both remembrance of what happened with a fear of what might be yet to come. The fear of another attack has been nagging away at New Yorkers throughout the past year, more often privately harboured than publicly acknowledged.

There was a brief moment of collective panic around Memorial Day in late May, after the federal government started sharing its fears that terrorists might target cities with weapons of mass destruction and the *New York Times Magazine* ran a cover story exploring what might happen if a dirty nuclear bomb went off in Times Square. But this week's ceremonies have pushed these fears once more to the forefront of people's minds.

How can New Yorkers achieve the “closure” most of them yearn for when they know that those who took their friends and colleagues could at any moment come back for them? There will be a collective sigh of relief once this anniversary week has been (hopefully) safely negotiated. But most New Yorkers will not forget that what made the city such an attractive target a year ago continues to make it the likeliest focus for any future attack in America.

A year ago, it was routine to say that the city, along with the world of which New York is the self-proclaimed capital, had been changed forever. More recently, such claims have increasingly been questioned, even dismissed as overblown clichés. Certainly, the mass exodus from New York that some

predicted a year ago did not happen. A few Manhattanites fled to suburban safety, but most stayed.

The city's boosters claim that people were bonded more closely than ever to the Big Apple by the communal pulling together of the recovery effort. It is debatable whether this would have happened if the terrorists had struck again, or had done so more effectively than with the few anthrax-carrying letters that were received last October from still-unknown authors. For now, the lure of New York has persuaded most of its inhabitants to gamble that September 11th was a one-off.

A second attack could dramatically alter such calculations for all Americans (see article). But New Yorkers are understandably more nervous than most other Americans. In June, a Gallup poll showed that 19% of New Yorkers were very worried that they or a family member would become a victim of a terrorist attack in America, and another 34% were somewhat worried. This compares with 8% and 31% nationally (and the latter figures include two other cities recently hit by terrorism, Washington, DC, and Oklahoma City). Only 12% of New Yorkers said they now felt safe, down from 42% before September 11th.

A new CBS/*New York Times* poll suggests that fear of terrorism has eased a little in recent months. Even so, only 33% of the New Yorkers asked in the new poll expect their city to be a better place in the next 10-15 years, down from 54% a year ago. Only 57% of them want to be living in New York in four years; a year ago, the proportion was 67%.

This pessimism partly reflects the city's economic difficulties. New York's businesses have mostly stayed put—at least, those that have been able to stay afloat. Some public money went to aid firms in the vicinity of the World Trade Centre, especially small ones that catered to those who worked there—but that was not always sufficient to keep them going. All the same, much of New York's recession, which started in early 2001, is due to national and global problems that have had little to do with the terrorist attacks. Both Wall Street and Madison Avenue were in trouble before September 11th.

This makes any estimates of the job losses associated with September 11th highly speculative. The city's unemployment rate rose to 7.7% in July, up from 6.3% in August 2001. The national rate jumped from 4.9% to 5.9% during the same period. Around 83,000 jobs disappeared from the city, and a further 63,000 that would have been created were not, because of the attack, according to a recent report issued by William Thompson, the city's comptroller. This report put the total cost to the city of the attacks at a massive $83-95 billion, after accounting for every conceivable loss from higher borrowing costs to ruined property.

Such calculations surely overstate the terrorist impact, because they assume that the attack stopped a nascent economic upturn in its tracks. That gives insufficient weight to the damage that Wall Street would have suffered anyway due to the crisis of investor confidence following the collapse of Enron, the accounting scandals and so forth.

Those who stay away

The industry that was most clearly hit by September 11th was tourism. The occupancy rate at the city's hotels plunged to a miserable 62% last September (from 89% in September 2000), and their revenues fell to $246m (compared with $448m). Yet the situation has been improving steadily since then.

By June, the occupancy rate had risen to 78%, roughly the same level as the previous year, albeit with lower prices. Revenues for Broadway shows, which plunged in the last four months of 2001, were actually higher in May 2002 than in the same month last year. Air travel to New York is also rebounding, though it remains significantly lower than it was before the terrorists struck. And there has been a significant shift in the mix of tourists visiting the city, with a rising number of American travellers partially filling the gap left by typically higher-spending foreigners who are staying away, especially the Japanese.

All the same, there is no doubt that New York (for whatever reasons) is worse off than it was this time last year. The result is that the city faces a looming budget crisis, with a likely deficit of at least $2 billion next year that will be solved only by some combination of higher taxes and cuts in services. This year, hard budget decisions were postponed by using the September 11th attack to justify borrowing $1.5 billion to cover the city's operating expenditures. This trick surely cannot be pulled off twice.

Steve Malanga of the Manhattan Institute, a rightish think-tank, is also pessimistic about renewed attempts, led by Senators Hillary Clinton and Charles Schumer, to get more federal aid for the city,

including some to ease its budget woes. Congress has already given more than the $20 billion initially pledged by George Bush to clean up the World Trade Centre. But politicians from other states are unlikely to see why the federal government should help with the general expenses of what is the biggest-spending city in America.

The task of solving the budget crisis will fall to Mayor Michael Bloomberg. The billionaire businessman is usually seen as one of the post-September 11th winners (if such a word can be so used): he would probably have lost the mayoralty to Mark Green, a leftish Democrat, had the terrorist strike not happened. Yet it is also worth noting that his election probably spared New York city a turbulent period of score-settling over Rudy Giuliani's legacy.

During his eight-year reign, Mr Giuliani bullied through a wide range of reforms, most conspicuously in policing. But the sheer scale of his assault, coupled with a personality of Thatcherite bluntness, created a backlash. Mr Giuliani's critics, of whom Mr Green was one of the loudest, were silenced by his heroic leadership of the city after September 11th. Then Mr Giuliani's endorsement of Mr Bloomberg clinched his narrow victory.

Under Mr Bloomberg, a decidedly less ideological figure than either Mr Green or Mr Giuliani, the reforms have continued, with a few pragmatic twists. The crime rate is still going down. The mayor has been able to secure personal control of the city's schools. The current need to rebuild the city, and the public's recognition that finances are tight, have also taken some of the partisanship out of City Hall politics. Hopes even remain high that agreeing on a plan for what to do with Ground Zero will proceed without too much rancour, despite the lukewarm reaction to the first set of proposals unveiled in July.

A sweeter Apple

Behind this lies a conclusion that sounds trite and is impossible to prove: New York has become a nicer place. New Yorkers proclaim this frequently. But the city's impressive reaction to the attack has endeared it to the rest of the American people, many of whom had come during the previous half-century to regard New York as a godforsaken un-American place.

The ceremonial meeting of Congress in New York on September 6th symbolised this change in the city's status. Meanwhile, the public's spontaneous applause and cheers for the visiting Washington politicians showed that New Yorkers welcomed it. Ironically, through the loss of its tallest buildings, the city has resumed its traditional role, well described by E.B. White in “Here is New York”, his classic 1949 essay: “It is to the nation what the white church spire is to the village—the visible symbol of aspiration and faith, the white plume saying that the way is up.”

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Iraq and the UN

Mr Bush lays out his case

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From The Economist print edition

The president's speech at the UN has pushed the stakes over Iraq even higher

IRAQ is “a grave and gathering danger”, George Bush told the General Assembly of the United Nations on September 12th—not just to the United States but to the world. In a powerful and well-judged speech, the president called on governments everywhere to recognise that fact, and challenged the UN to respond to Iraq's “flagrant violations” of resolution after resolution. Mr Bush demanded no specific steps, proposed no timetables. He made it clear that America, in the end, would act alone against Iraq if need be. But he also made it plain that America would rather move in concert with others. He praised the UN, then called on it to live up to its responsibilities. His speech aimed to shift the burden of proof—and in some measure did so. In the face of the Iraqi government's crimes, he asked, how can the UN justify failing to act?

It had been a week of mounting pressure on Iraq. Over the weekend, Mr Bush met his closest ally, Tony Blair, for what was called a “war summit”. On September 11th, in his address to the American people, Mr Bush, the Statue of Liberty glistening behind him, reiterated his determination to separate “tyrants” from weapons of mass destruction. On the same day, the Pentagon said it was sending 600 staff from its Central Command in Florida to the Gulf, ostensibly for a temporary exercise, but with everybody dropping hints that the generals would stay there longer to deal with Mr Hussein.

Mr Bush's speech to the UN also came against a background of tougher talk from some European allies, who had been widely assumed to be unwilling to face up to Mr Hussein. Last week, European foreign ministers demanded that Iraq let the inspectors back in, or else. This week, Jacques Chirac explained what this might mean. One UN resolution, said the French president, should give Mr Hussein three weeks to admit the inspectors. If Mr Hussein refused to comply, the world would have to consider a second resolution on whether there should or should not be an intervention. The wording would be crucial to France's own position.

That was woolly, but it did add to hopes that intrusive weapons inspectors, not war, might be the next step. Speaking before Mr Bush, the UN's secretary-general, Kofi Annan struck a similar note. He argued that “there was no substitute for the unique legitimacy provided by the UN.” But he also insisted that “if Iraq's defiance continues, the Security Council must face its responsibilities.”

If Iraq accepted a completely uninhibited inspections regime, and complied in all respects with the demands the UN has already placed upon it, would that avert war? Without saying so explicitly, the president implied that it would. His insistence on “regime change” was somewhat tempered: he talked instead of the “prospect” of a new and different kind of government, at some unspecified point after Iraq had decided to behave. This part of the speech sounded more like Colin Powell than Dick Cheney or Donald Rumsfeld, who are known to regard inspections as useless, or worse.

At the moment, UN Resolution 1284 constitutes a standing offer to Mr Hussein: if the Iraqi government manages to satisfy the inspectors in every respect and co-operates in setting up a monitoring system, then sanctions could be swiftly suspended. Messrs Cheney and Rumsfeld still fear Mr Hussein would be able to run rings round such a regime, as he has before.

Several outsiders had argued that if Mr Bush went to the UN and proposed a new inspection regime with *carte blanche* powers of search and with military personnel on hand to help, it might have been accepted by the rest of the Security Council. He has not yet done that, in so many words. Instead, he produced his long and devastating list of Iraq's transgressions—and said that America would work with the Security Council to give Iraq one last chance. But the president warned sternly that “the purpose of the United States should not be doubted.”

In a sense, Mr Bush has put the onus for designing a new resolution and making the inspections work on to the UN. If the Security Council proposes a tough regime, and if Mr Hussein accepts it, so much the better. Yet there are risks in America asking others to make the next move.

In the 1990s, Warren Christopher, Bill Clinton's secretary of state, was similarly frustrated by European reluctance to confront Slobodan Milosevic over Serb actions in Bosnia, and also said that he would wait while the Europeans sorted out what they wanted to do. The result was disagreement within NATO ranks while Serbs committed atrocities.

A policy of delegation risks getting America the worst of both worlds. If the other members of the Security Council propose having one more try at implementing the existing weapons-inspections regime, and if Mr Hussein accepts it (only to prevaricate again), Mr Bush would face an unenviable choice. He would either have to accept an inspections regime he disliked, or choose to disregard the very procedure he had just invoked and attack Iraq regardless.

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West-coast ports

Slinging their hooks

Sep 12th 2002 | LOS ANGELES AND SAN FRANCISCO
From The Economist print edition

The west-coast dockers are blue-collar royalty. Will they be dethroned?

GOODS worth $300 billion flow in and out of west-coast ports each year, $220 billion of them through the giant terminals at Los Angeles-Long Beach. All this is loaded and unloaded by 10,500 dockers who belong to the International Longshore and Warehouse Union (ILWU). On July 1st, the contract between these dockers and the Pacific Maritime Association (PMA), which represents the shipping lines, expired. Until September 1st, the contract was extended one day at a time. Since then work has proceeded without any formal contract.

So far the cargoes have kept moving, with the work going on under the old terms, but a new contract needs to be negotiated. Any stoppage would hammer the economies of both America and Asia.

The ILWU has tremendous power not only over the PMA, but also over a swathe of American businesses, from retailers to manufacturers. The threat of a strike has long helped the union maintain high wages and unrivalled benefits. But the balance of power is changing. The shipping lines and their customers are better organised this time. And the White House, with one eye on the economy and the other on national security, has implied that it would intervene to prevent a stoppage.

The ILWU is rallying political forces of its own. All the west-coast senators have asked George Bush not to intervene. In London, the International Transport Workers' Federation is demanding that dockers in other countries support the ILWU if it is prevented from striking.

The underlying issue is technological change. The PMA and the rest of the supply-chain want the ports to operate more efficiently. Most big ports around the world use scanners and electronic data-transfer to speed containers through the docks, but on the west coast clerks still copy numbers down by hand and type them back into computers. West-coast ports also operate only eight hours a day; the other big ports work round the clock.

The union does not object to new technology. In the 1960s, it collaborated in the revolutionary introduction of containers, recognising that gains in efficiency could make up for lost jobs by raising the volume of trade. It was right: the amount of goods going through the ports has quintupled since 1980, and union membership, which fell from 16,000 in 1965 to 6,500 in 1983, has since climbed back to 10,500. But the ILWU frets that if data-processing replaces waterfront clerical work, it will lose control of it and, eventually, lose power.

The dockers are facing a challenge common to many other American unions. Structural change, away from manufacturing and towards services, has contributed to a drop in union membership from 22m in 1980 to 16m today. Even in its manufacturing heartland, barely one in seven American workers belong to a union.

A question of power

For the ILWU, the movement of jobs away from the waterfront and into a computerised back office, perhaps in another state, strikes at the heart of its culture. Union solidarity is hatched in the “hiring hall” to which workers report each day. Terminal operators hate the system: it delays the arrival of workers on the job in the morning, and since workers may be sent to a different terminal every day, it means that they do not build up loyalty to the firm that actually pays their wages.

Shipping lines share the blame for inefficiency, however. Each of the 14 different Los Angeles container terminals uses a different computer system, so a worker must spend time relearning what to do. Shipping lines justify the difference as a source of competitive advantage, but in practice it slows things down.

Even if the struggle between the global forces of trade and the practicalities of the waterfront remains locked, other pressures will soon force change. Gray Davis, the governor of California, is preparing to sign a bill—pushed by an unlikely alliance of frustrated truck-drivers and environmentalists—that would fine the operators of terminals that keep lorries waiting to pick up containers. Complying will mean giving drivers fixed appointments—and that will require better management of information. So, too, will federal anti-terrorism laws requiring identification cards for all transport workers. Whatever happens, data-processing is coming to the docks, and dockers will have to get used to it.

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The mid-term elections

Politics goes on

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From The Economist print edition

And the Democrats have reason to be pleased

SEPTEMBER 10th was not just a prelude to September 11th. It was also the second-most-important day in this year's electoral calendar: the day when 12 states and the District of Columbia completed the process of choosing their candidates for the November mid-term elections.

The primaries were dominated by a spirit of pragmatism. Across the country, party establishments did their utmost to make sure that their most electable candidates won the nomination. This meant eschewing ideological firebrands for sensible-looking people with a track record of solving problems.

The obvious reason for this is that America is a 50-50 nation: from Congress down to the state houses, the parties are evenly balanced. The Republicans are one seat away from taking control of the Senate. The Democrats are six seats away from taking control of the House. If the Democrats can win the governorship of a pivotal state such as Florida, they increase their chances of retaking the presidency in 2004. Nor is America in an ideological mood: the combination of the war on terrorism and the weak economy is predisposing people to look for pragmatic solutions to pressing problems.

Party establishments do not always get their way. In March, the White House failed to persuade California's Republican Party to choose Richard Riordan, the middle-of-the-road former mayor of Los Angeles, over Bill Simon, an untried ideologue. (Mr Simon has been flailing ever since.) But September 10th saw the establishment winning across the board.

In the New Hampshire Senate race, Bob Smith, the state's Republican senator, lost to John Sununu, a congressman. Mr Smith had infuriated the party's establishment with his hardline conservative politics and idiosyncratic behaviour. He mounted a risible run for the White House in 1999; loudly quit the Republican Party to continue his run as an independent; and then rejoined the party just in time to assume the chairmanship of an important committee. Mr Sununu, on the other hand, is a solid party man, the son of a former governor and White House chief of staff in the first Bush administration.

In the Florida governor's race, Janet Reno, a former attorney-general, seems to have lost by a whisker to Bill McBride. After another fuss about voting machines (see article) the election had not been certified when *The Economist* went to press, but Mr McBride had a lead of around 10,000 votes. Ms Reno started off as the front-runner, thanks to her celebrity status and strong support among blacks and the elderly. She tried to keep her popularity alive by driving around the state in a red pickup truck and hosting a “Janet Reno Dance Party” in a South Beach club. Mr McBride, by contrast, was an unknown first-time candidate.

But the party establishment never warmed to Ms Reno. They regarded her as too liberal, too idiosyncratic, too scarred by her role the Clinton administration, particularly in the deportation of young Elian Gonzalez back to Cuba, to stand a serious chance of unseating Jeb Bush. Mr McBride, a decorated Vietnam-war veteran, won the endorsements of the Florida teachers' union, the state AFL-CIO and a slew of newspapers, besides using his financial advantage over Ms Reno to air expensive television ads.

In the North Carolina Senate race, Erskine Bowles, Bill Clinton's former chief of staff, beat off a grass-roots challenge by Dan Blue, a black state representative, to face Elizabeth Dole in November. In Maryland, Christopher van Hollen, the local party's favourite, came from behind to defeat a member of the Kennedy dynasty, Mark Shriver, in another example of Camelot's fading charms. It looks almost certain that Anthony Williams will defeat a challenge from Willie Wilson, a clergyman and associate of Marion Barry, and keep his job as the capital's mayor.

This year's primaries saw the development of a new political technique: picking your opponent. Gary South, Gray Davis's political guru, pioneered this technique by airing advertisements during the Republican primary demonising Mr Riordan, the candidate the Democrats most feared. Florida Republicans ran attack ads against Mr McBride. North Carolina Democrats tried to smear Mrs Dole for her association with Ken Lay, the disgraced ex-boss of Enron. In New Hampshire, where over a third of the voters are independent, Democrats may have crossed over to vote for Mr Smith. But the technique does not seem to have travelled well outside California: indeed, Mr McBride used the fact that the Republicans were trying to demonise him as evidence that he was a better candidate than Ms Reno.

These primaries have set the stage for a number of very close races in November. Most are good news for the Democrats. Erskine Bowles could make Mrs Dole's life difficult. He has made a small fortune as an investment banker, and he comes from one of the most prominent political families in the state. His pragmatic style and business background should go down well with whites, while his connections with the Clinton administration could bring in the black vote.

Mr McBride also has a chance of beating the president's brother. Mr Bush has been dogged by well-publicised problems with the state's Department of Children and Families, which has a habit of misplacing children in its care, and with his own daughter, who was caught in possession of cocaine this week. The fact that the governor has evidently failed to keep his promise to improve the state's voting machinery may also cost him votes after this week's debacle.

The Republicans received more bad news from New York, albeit of an eccentric sort. It looks as if Thomas Golisano, a multi-millionaire who wants to spend pots of money trying to take the governorship away from George Pataki, has secured a place on the November ballot as the Independence Party candidate. The Republicans will now be forced to spend valuable time and treasure trying to defend two governorships, Florida and New York, that until recently looked like shoo-ins.

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Florida's new voting machines

If you really want to screw things up

Sep 12th 2002 | MIAMI
From The Economist print edition

Install computers and skimp on the training

AFTER Florida's disastrous presidential election two years ago, state officials were given $32m to update voting equipment at polling stations. But the state still couldn't get it right. Instead of “hanging chads” and ambiguous ballot-papers, this time it was spanking-new computerised voting machines that caused all the grief. As the overseeing secretary of state (a man called Jim Smith, sadly no longer the fragrant Katherine Harris) put it, “What the hell have they been doing for the past two years?”

The biggest snafus were in the same three South Florida counties—Miami-Dade, Broward and Palm Beach—where most of the problems ocurred in 2000. In Miami-Dade, many of the county's 754 polling stations opened late. A few were not up and running until the afternoon, more than five hours after they were meant to be. Thousands of voters had to be turned away, and not all could come back later. Governor Jeb Bush, calling the mess “shameful”, declared a state of emergency to force the polls to stay open two more hours, until 9pm.

In some cases, poll workers simply failed to turn up. Where they did, they often did not know what to do with the shiny gizmos in front of them. The new touch-screen system requires voting machines to be booted up with a cartridge before they can be used, a process that takes about six minutes. In their haste, some workers pulled out the cartridges too soon, crashing the machines.

Officials waited too late to train poll-workers on the new equipment. In Miami-Dade and Broward some poll workers, mostly elderly people unfamiliar with computer technology, didn't like the newfangled system and dropped out of classes. Election officials scrambled to replace them.

All this could well have affected the outcome of the Democratic primary between Janet Reno, a former attorney-general, and Bill McBride. South Florida's three counties have by far the biggest number of voters. Their large black and Jewish populations are Ms Reno's stronghold, where she out-polled her rival Mr McBride by a margin of more than two to one.

Yet voters were unable to cast ballots until nearly mid-day at one Miami precinct, Jordan Grove Missionary Baptist Church in Liberty City, a poor black neighbourhood that is strongly pro-Reno. All the poll workers had been to their classes, but the machines would not boot up properly. “We turned away about 450 people. It was a huge turnout,” said Pam O'Riley, a Reno campaign worker, standing outside in the rain. “I was in tears at one point. This will definitely hurt her campaign.” Whatever the final result, the recriminations will continue. The next test will be the election in November.

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Lexington

A ghastly probability

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A second terrorist attack would probably change America even more than the first one did

THERE is never a good time to contemplate the possible murder of more Americans. As the country pauses to mourn the dead in New York, Washington and Pennsylvania, now may seem more than usually inapposite. It may also be necessary.

September 11th 2001 was an all-consuming moment. It saw the most grievous one-day massacre in America since the civil war. It is not surprising the anniversary commemorations have grabbed so much attention. But the character of the observance is revealing. Despite the fresh round of warnings this week about the possibility of another attack, many Americans—perhaps most—still seem to treat the attacks as if they were a single, dreadful event, like a natural disaster, or a random crime committed against America, with the Bush administration meting out punishment, most of it abroad.

Yet the destruction of the World Trade Centre was not a one-off event. Al-Qaeda attacked America four times in the past decade, bombing the World Trade Centre for the first time, the Khobar towers in Saudi Arabia, two East African embassies and the USS Cole. Last year's atrocity was different in scale, not in kind. It was a fifth attack. Since then, al-Qaeda has been badly wounded, but it has certainly not been destroyed. It has committed some subsequent acts of terror, and failed to carry out more. Members of its inner circle are said to be regrouping in Iran, Afghanistan and elsewhere.

Now imagine how Americans might react if these al-Qaeda remnants resumed operations—if, say, the prime minister of Afghanistan were assassinated, or if hundreds of American soldiers were killed at a base in Germany. These events are not hard to imagine: both came within a whisker of occurring recently. But the biggest psychological impact would come from an attack on the United States itself—and here the possibilities remain frightening, because they need not be as sophisticated as the last attack. It would not be hard, for instance, for 10 suicide bombers to attack malls around the country.

Yet America seems unwilling to indulge in such imaginings. Nobody took that much notice of this week's warnings (perhaps because there have been so many before). Turn-out in the primary elections fell a bit, though not sharply. The current attitude to future attacks seems to be nervous denial: people do not want to think about it. Even memories of the anthrax letters have faded: these are not seen as part of a pattern of attacks because Americans do not think they had anything to do with al-Qaeda. All this stands in sharp contrast to the outpouring of grief over the mass murders of a year ago.

The difference is important. September 11th reminded Americans of things that make them special—exceptional patriotism, religiosity and willingness to use force abroad for moral reasons. But it did not fundamentally alter the way the country is run or how Americans think about themselves. Another attack would. The World Trade Centre would more clearly become what George Bush has long insisted that it was: an act of war.

And war is different. In war, the long conflict itself is what matters. Individual atrocities—even one as big as September 11th—become secondary, important not so much in themselves but for what they tell you about the wider struggle. Wars, including long-drawn-out ones against terrorists, take on a momentum of their own.

Prepare yourself

So a second strike would surely change America more than the events of September 11th alone did. But how? The best hope would be that Americans would react rather as they did in 1941, with a great outward-looking surge of determination to root out terrorists in concert with their allies. The worst fear is the opposite: America could begin listening to the sirens of isolationism again. Some voices would surely be raised, complaining that the country gets nothing from the rest of the world and should retreat from it. These voices would surely not prevail. There is no popular support for isolationism now. And disengagement would be enormously costly, even impossible (because America's enemies are already inside the country).

The most likely reaction would be bloody-minded unilateralism—of the sort Mr Bush is often accused of now. Americans might well say, in effect, “We are being attacked. Not Europeans. Not Middle Easterners. Us. We consulted with you over Afghanistan and even Iraq. Now we will act as we see fit.” Mr Bush's inner circle would surely become even more likely to disregard international treaties, even more likely to lash out against potential foes and even more defiantly pro-Israel than it already is. Some European and Arab allies might regard this as little better than outright isolationism. A bigger version of the existing gap would open up—with Mr Bush smiting his enemies and his allies whingeing about the underlying causes of terrorism.

A sobering possibility, and one that might yet be avoided. Look at the question of more terrorism another way: in the light of another attack, how would Mr Bush's current strategy be reassessed? The president's defence would be easy: all along, he has been treating the battle with al-Qaeda as a long-term war. All the same, if an assault happened next month, or next year, Mr Bush's critics would carp on about three things. First, he should have found more common ground with America's allies. If only he had been seen to be doing more to tackle those underlying grievances. Second, they will say that he should have built more bipartisan support at home for his social and fiscal policies. Lastly, they will argue that the president could have done more to prepare the country for war—not merely by issuing colour-coded warnings but by forgoing future tax cuts to finance an escalating struggle with terror. A fearful list, which Mr Bush will dismiss. But if he believes his own rhetoric, it is a political struggle he will have to prepare for.

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Trade in the Americas

The geopolitics of orange juice

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From The Economist print edition

Panos

The battle for an Americas-wide free trade pact is hotting up. Its prospects depend in part on Brazil's election campaign

IT IS more than a decade now since President George Bush's father first floated the idea of a Free-Trade Area of the Americas (FTAA). Since 1998, negotiators from 34 countries have been quietly working to try and conclude such a pact, which their political leaders have agreed should come into force by January 2005. But although the idea has influential champions and bureaucratic momentum, it has never been clear whether the United States and Brazil, respectively the largest economies in North and South America, will end up throwing their full political weight behind the proposed FTAA. The next few months may settle that question.

Having seen how Mexico's exports have boomed under the 1994 North American Free-Trade Agreement, many other Latin American governments, faced with torpid economies, are desperate to get better access to the America market. But over the past year, relations between Latin America and the United States have been difficult. Despite Mr Bush's declarations of love for the region, the war on terrorism has imposed other priorities. The administration's seeming indifference to Argentina's economic collapse caused dismay in the region. Huge new subsidies for American farmers, and tariff protection for its steelmakers, enraged Brazil.

Recently, though, the United States has performed several about-faces. Last month, Congress finally approved an omnibus trade bill, which grants the administration the “fast-track” authority needed to clinch trade deals (this means that legislators can reject but not amend them). Days earlier, the administration had proposed that the current round of World Trade Organisation (WTO) talks should agree to worldwide cuts in farm subsidies. And the United States' Treasury not only backed a $30 billion IMF loan-package for Brazil but itself stumped up a $1.5 billion bridging loan for Uruguay.

American officials express optimism that the FTAA talks will now move forward according to schedule. This calls for the United States and Brazil to take over the joint-chairmanship of the talks at a ministerial meeting in Quito, Ecuador's capital, on November 1st for the final, tough, phase of bargaining.

Hope and disquiet

But the FTAA prompts disquiet as well as hope. Robert Zoellick, the United States' Trade Representative, this week met his counterparts from the Caribbean, who are worried about their small countries' ability to compete. Venezuela's president, Hugo Chavez, a populist, is a critic of the plan: his government says it

may hold a referendum on the FTAA next year.

In Brazil, long more sceptical than many of its neighbours, the FTAA has become an issue in next month's presidential election. This month, Brazil's Catholic bishops organised a “plebiscite”, inviting the public to express opposition to the proposed accord. Against, too, until recently were Luiz Inacio Lula da Silva, who leads the polls for the election, and his left-wing Workers' Party. But the prospect of power has softened their stance; they withdrew backing for the church's plebiscite. Mr da Silva still calls the FTAA an “attempt at annexing Latin America” by the United States. But though he is against it “as it is currently being negotiated”, he says he might accept a deal that gave Brazil fair access to America's market. For his part, Jose Serra, the government candidate, whom polls place second, joins in the attacks on American protectionism while insisting he is best-placed to negotiate it away.

Many Brazilians blame freer trade for lost jobs: after opening up its economy in the early 1990s, Brazil suffered big trade deficits. Now, with a weak currency, the country is heading for a trade surplus of $7 billion this year; similarly, Brazil's trade with the United States has moved from deficits to a likely surplus of around $3.5 billion this year. The turnaround is mainly due to a fall in imports as the economy has slowed. Brazil urgently needs to boost exports, to grow while cutting its dependence on foreign financing.

But powerful interest groups are sceptical about the FTAA. Sao Paulo's industrialists' federation has published a study suggesting that the pact could lop $2.2 billion a year off Brazil's trade surplus. Sergio Amaral, the trade minister, is sceptical of this and has commissioned fresh studies, due to be released later this month.

An FTAA might settle some bitter trade rows between Brazil and the United States. Brazil has filed a complaint to the WTO over the new steel duties (though its exports were exempted from most of these). As well as high tariffs, Brazil's orange juice (it is the world's biggest producer) faces a surcharge levied by the American state of Florida—the subject of another complaint at the WTO. Brazil may also challenge America's subsidies to its cotton farmers at the WTO. And it complains about high American tariffs on its exports of sugar, textiles, tobacco and ethanol.

Some Brazilians argue that the WTO is a better forum than the FTAA in which to achieve free trade. Brazil has repeatedly said that an FTAA must encompass farm subsidies and “anti-dumping” measures, but American officials say they will negotiate these only at the WTO talks (which are likely to drag on beyond their 2005 deadline). Brazil had once hoped to head a powerful block at the FTAA talks, centred on Mercosur. But Argentina's collapse has turned Mercosur into a shell. And that has taken the urgency out of free-trade talks between the European Union and Mercosur (also supposed to finish in 2005).

Meanwhile, the United States is close to completing a bilateral trade deal with Chile. The omnibus trade act also extended duty-free access for farm (and now textile) exports from the Andean countries (except Venezuela), seen as alternatives to illegal drug production. This all adds to Brazil's relative isolation in the FTAA talks.

American officials insist that such deals are a way of building momentum towards the FTAA. They, too, face doubters at home, and have their own wish-lists. A meeting in New Mexico of American sugar farmers in early August heard a presentation entitled: “Brazil: Poised to Swamp All of US Agriculture”. The United States insists that government procurement should be covered by the FTAA, something which Mr da Silva might object to. He says he would reverse a recent decision by Petrobras, the state oil company, to buy drilling platforms from Singapore. He argues that government business should be used to create jobs in Brazil.

Despite such public slanging, progress has quietly been made in preparing the final stages of the talks, says Jeffrey Schott of the Institute for International Economics, a Washington think-tank. The chances of success will become clear only by mid-2003, when all the countries have put their offers on the table. Brazil and the United States each expect sweeping concessions from the other. Both will also be tied up with the WTO talks, and Brazil with those with the EU too. With so much bargaining to be done, the timetable may slip, and a deal might not come till 2006. But slow though the process is, it still shows stubborn signs of life.

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Healthcare in Chile

A new prescription

Sep 12th 2002 | SANTIAGO
From The Economist print edition

A minimum plan for sickness—and health

Get article background

SINCE last month, children with cancer and adults with heart disease or kidney failure have enjoyed the right to be treated within a specified time in Chile's hospitals. By 2004, another 53 diseases should have been added to this list, as part of a big shake-up in health care launched by President Ricardo Lagos's centre-left government. The aim is to tackle the unfairness and ineffiencies that besmirch one of Latin America's better health systems.

On basic health indicators, Chile scores well. Infant and maternal mortality are among the lowest in Latin America. Average life expectancy is almost 76 years, up from just over 60 years in the early 1970s. But the average conceals glaring inequality. Infant mortality in a poor rural community of southern Chile is four times the national average and sixteen times that of a prosperous Santiago suburb, according to a recent study. That mirrors unequal income distribution. But it is also a result of changes introduced by General Augusto Pinochet's dictatorship of 1973-90.

All Chileans with jobs pay at least 7% of their salary to health-insurance providers. Since the dictatorship, those who wish (1m, or 20%, do) can pay this not to FONASA, the public health-insurance fund, but to private funds known as Isapres. These offer swift access to well-equipped private clinics—for a price. The average contribution to an Isapre is 9% of (above-average) salaries. Even so, members pay out a similar amount on top of their contribution for off-plan items and prescription drugs, according to the government. FONASA, which is topped up with a public subsidy, buys care at (dowdier) private clinics as well as public hospitals.

Since 1990, democratic governments have thrown more money—three times more—at the public system, but without reforming it. Waiting lists are long. Public hospitals, which must offer free care to the poor, are overstretched, after years of past underinvestment. But they are also grossly inefficient. Even General Pinochet quailed at taking on medical unions. So hospitals cannot sack specialists, even when they have too many of them and too few of others; doctors with more than 20 years service work short hours.

The reform centres on the new minimum-care plan, offering guaranteed free or low-cost treatment for 56 ailments that between them are responsible for three-quarters of years of life lost because of premature death or disablement. This plan, which both the public and private systems would have to offer, would be paid for from a new national fund, into which wage-earners would pay part of their contribution. The Isapres would no longer be able to charge more to elderly patients, at least for the minimum plan. Hernan Sandoval, the reform's author, says he hopes that these changes will direct resources where they are most needed, while encouraging patients to demand their rights.

The reform is popular with the public—but not with health workers. Doctors see standardised treatment as a first step towards managed care and, therefore, as a threat to their incomes. Public sector health-workers worry that job security could be at risk. The Isapres are wary, but see some advantages. The new system would give them greater control over who provides treatment, and therefore over costs, without impinging on their freedom to offer top-up coverage.

But the biggest sticking point may be opposition in Congress to the tax increases required to pay for the reform. The government says the reform will add an extra $230m to Chile's total spending on health of $4.3 billion (or 6% of GDP). Most of the extra money would come from the public purse. So it is not clear whether the government will get its way. If it does, it might just make Chile's health system fairer and

more efficient—but at a cost.

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Gambling in Canada

Hard luck story

Sep 12th 2002 | MONTREAL
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Losing their heads over lotto

CANADIANS like to think of themselves as prudent, level-headed, people. Yet that self-image is a little out of date. In less than a decade, the amount they lose in lotteries, casinos, slot machines and the like has quadrupled. The average Canadian now admits to spending C$424 ($270) per year gambling. Since most people lie to themselves about such matters, the true figure may be as much as C$1,000.

Only a generation ago, charity bingos and church raffles were about as risky as things got. Now there are 60-odd casinos scattered across the country; many are in Indian reservations, where they are valued for jobs as well as revenue. Daily lotteries often pay out C$10m or more. Video-lottery machines, dubbed gambling's crack-cocaine for their cheap, fleeting thrill, are particularly popular. Staff in corner shops now regularly ask customers whether they want a lotto (loto in French-speaking Canada) with their shopping.

All of this is manna for Canada's provincial governments, who are the monopoly owners of legal gambling outlets. These provided profits totalling C$6 billion in 2001. In Alberta, the richest province thanks to its oil and gas, gambling may soon overtake corporate income tax as a source of revenue.

Perhaps that is why governments have seemed reluctant to consider gambling's social impact. “They don't ask the questions they don't want to know the answers to,” says Jason Azmier of Canada West Foundation, a Calgary-based think-tank which recently concluded a three-year study of gambling.

But some are starting to ask questions—or at least to look for others to blame for their own stupidity. Loto-Quebec, the agency that runs gaming in the province, is being sued for almost C$700m on behalf of an estimated 125,000 pathological gamblers. This class-action suit is led by Jean Brochu, a lawyer from Quebec city, who embezzled C$50,000 from his professional body to feed into video-lottery terminals. It is backed by another government agency, the coroner's office, which blames gambling for 71 suicides in the province between 1999 and 2001.

More predictably, churches also rail against government's embrace of gambling. They argue that Canadian Indians are the most hurt by the casinos on their reservations. Pathological gambling is ten times more common among Indian peoples than other Canadians. On and off the reserves, gambling brings child poverty, stress, marital breakdown and crime, say its critics. They include John Ralston Saul, a writer and the husband of Canada's governor-general, who has denounced “the state funding the public good by corrupting the citizen”.

But Canadians seem unmoved by these pleas to be protected from themselves. Canada West Foundation found that they placed gambling behind highway speeding in the hierarchy of social ills. Faced with a choice between more gambling or higher taxes, more than three times as many plump for the first.

Mr Azmier reckons Canada has up to 1m problem-gamblers, but they are invisible. “It doesn't make you stumble. You don't slur your speech. It can't be smelled on your breath,” he says. As a result, Canadians are unaware of the social cost of government's profitable love affair with gambling. Even if some provinces have made gestures aimed at slowing the industry's growth, the amount transferred each year from the pockets of citizens to government coffers is set to keep on climbing.

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Mexico city

Centre of belated attention

Sep 12th 2002 | MEXICO CITY
From The Economist print edition

An effort to revive a historic slum

THE huge square known as the Zocalo is no longer the beating heart of Mexico city, as it was in Aztec times. But it is surrounded not just by a maginficent cathedral but by nine square kms (3.5 square miles) of Spanish-colonial houses, churches and public buildings, some dating back to the 16th century. This should be one of the most compelling architectural destinations in the Americas. Instead, much of it is a slum of gutted buildings, dark and dirty streets blocked by milling vendors, and garbage-strewn vacant lots.

The reasons for this sad decline are partly man-made, and partly natural. In the 1940s, the city government froze rents in the city centre. Tenants paying 50 cents a week in 1950 were still paying the same in 1998, when the law was finally repealed. With no incentive to spend on upkeep, landlords let buildings disintegrate. A 1985 earthquake added to the Beirut look. The result: 100,000 city-centre residents, over a third of the total, have moved out in the past 20 years. By night, the area is almost deserted; fear of crime deters most visitors.

For a decade, attempts have been under way to rectify matters. Carlos Slim, Mexico's richest businessman, has bought up and renovated some of the old buildings to prevent their collapse. Now the city government has started to do its bit. Last February, it revamped the Historic Centre Trust, a quango, endowing it with a grant of 500m pesos ($55m).

The trust has begun work on renovating the 34 blocks in the heart of the historic centre, behind the cathedral. The streets are being dug up to replace the antiquated drainage system and to improve water supply. In an innovative move, an architect has been put in charge of each of the 13 main streets, charged with restoring the facades of more than 500 buildings. The makeovers have been designed in consultation with residents. Last week, Andres Manuel Lopez Obrador, the city's left-wing mayor, also announced the start of work on a new square.

Further ahead, the plan is to move the street vendors out of the area, says Ana Lilia Cepeda, the head of the Historic Centre Trust. That will be difficult: many of them bribe local officials to be there. The overall aim is to attract new residents to the centre, and with them cafés and restaurants—and a feeling of safety in numbers. If the promised street lighting, video cameras and the paraphernalia of modern urban security duly materialise, such gentrification may indeed follow. After all, surely somebody will want to live in some of Latin America's grandest housing.

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Kashmir's elections

A terrible beginning

Sep 12th 2002 | KUPWARA, SRINAGAR AND DELHI
From The Economist print edition

Reuters

On the eve of voting, a law minister is shot dead

Get article background

SOME trappings of a normal election are there. Buses bristling with megaphones and party flags barrel along the roads; dancers and drummers attend the candidates at village rallies. Lurking nearby, though, are camouflaged men with guns, and they are needed at this time. On September 11th, Mushtaq Lone, a candidate for the ruling party in the elections for the state assembly of Jammu and Kashmir, was shot dead along with six of his companions.

Mr Lone, the state's law minister, is the most prominent victim yet of Pakistan-based militants who are trying to disrupt the elections. Their ultimate purpose is to wrest India's only Muslim-majority state from its control. Mr Lone's murder raises the risk that the elections, which are to begin on September 16th, will not meet what is probably their most important objective: convincing India to resume talks with Pakistan after a breakdown in relations that pushed the nuclear powers to the brink of war this summer. India has made it clear that it will judge Pakistan's fitness for dialogue by the level of election violence.

The second electoral goal was already a lost cause: persuading separatist politicians to enter the democratic mainstream, to press their cause from the platform of the state assembly. There is a chance to salvage a final one: to prove that India can hold free and fair elections in a state where vote rigging has come to symbolise everything people hate about its rule.

Failure would reverberate widely. Colin Powell, the American secretary of state, said in Delhi in July that credible elections could be a first step toward peace in Kashmir and dialogue with Pakistan. In his remarks some Kashmiris saw hope. They have had their fill of war, which began 13 years ago as an indigenous rebellion against Indian rule and is sustained now by imported militants, who often indulge in sheer terrorism. Their crimes provoke brutality by Indian security forces. “We are facing two guns,” as a villager in Mr Lone's Kupwara district puts it. Many are also fed up with the National Conference party, which has ruled for the past six years and headed most of the state's elected governments. They think it achieved power through rigging elections and has done little with it but enrich its bosses.

Most Kashmiris in the Valley, the Muslim dominated part of the state, scorn both India and Pakistan: they want *azadi*, independence. If cynical Kashmiris turn out to vote, it will be in part because they think the Americans are looking on. “We are fighting elections on the assurance given by the Americans,” says Muhammad Amin Khan, a jobless man in a Kupwara village. “If they don't lead to a solution in Kashmir,

there will be bloodshed."

The United States wields influence only on the governments of Pakistan and India, and they have been resistant. Pakistan's dictator, Pervez Musharraf, condemns election violence, including the murder of Mr Lone, but outfits based in his jurisdiction are its most zealous practitioners. In May Pakistan-based militants murdered Abdul Gani Lone, a moderate separatist who was thinking of taking part. If the Kashmir elections are farcical, as General Musharraf has claimed, it is in part because groups operating under his nose are making them so. If this gets bad enough, India may refuse to talk to Pakistan and might even resume making warlike noises.

K. Rajendra Kumar, inspector-general of the Kashmir police, insists that infiltration by militants across the line of control, which divides the state into zones controlled by India and Pakistan, is as high as ever, despite General Musharraf's promises to stop it. The government in Delhi had been keeping an open mind about whether to talk to him after the elections, but outrages such as the murder of Kashmir's law minister are bound to shut it.

India, too, bungled its democratic prep work. It says that the separatists who decided to sit out the elections are beholden to Pakistan, tempted by its cash and frightened of its guns. But India's inducements were niggardly. Three top leaders of the All-Party Hurriyat Conference, the main separatist grouping, are in jail. India hinted that it would suspend the state government during the election to reduce the risk of rigging, then backed away for fear of offending the chief minister, Farooq Abdullah, whose National Conference party is part of the coalition that governs in Delhi. Any separatist who stood for election risked looking like a stooge, which might have been India's hope.

The Hurriyat is boycotting the polls, though unenthusiastically. A few pro-*azadi* candidates are contesting, but the bulk of the opposition is a motley, but largely pro-Indian collection of independents, defectors from the National Conference and mainstream parties, such as the Congress party. The voting could thus be perfectly free and fair without reflecting the will of the electorate. That does not mean the election will be a non-event. Resentment against the National Conference may be running high enough to topple it, which could bring in a government that is fractious but on better terms with the electorate. The party is fighting back with a new leader, Omar Abdullah, Farooq's son, who is bright, young and does not have enough of a track record to have disappointed the voters. It is well organised and will benefit if the turnout is low.

If an Abdullah scrapes back in, the six years of the next assembly might be a lot like the last, especially if the Indian government sticks to its line that it will talk only to Kashmir's elected representatives. There are hints that it may not. A committee of notables, which claims government backing, has lately been talking to Hurriyat leaders. One of them, Mirwaiz Umar Farooq, suggested on September 10th that they might settle for autonomy within India. This does not appeal to most Kashmiris, who have seen autonomy granted and then snatched away before. It seems scant recompense for the 30,000-70,000 Kashmiris who have died in the insurgency. But it might be made palatable by guarantees and amends for past abuses.

The decision, though, rests with India and Pakistan. Both countries' leaders were due to speak to the United Nations' General Assembly this week, General Musharraf on Thursday and India's prime minister, Atal Behari Vajpayee, on Friday. Some new thinking on bringing peace to Kashmir was hoped for. Autonomy would preserve India's territorial integrity, its highest priority; just possibly, it would allow Pakistan to claim credit for securing Kashmiris' self-determination. If they were reasonable, the Indian and Pakistani governments would agree on autonomy in some form. If the governments were honourable they could persuade Kashmiris that they were safe in settling for it. But neither government has displayed much reason or honour on Kashmir.

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Afghanistan

Insecure

Sep 12th 2002
From The Economist print edition

Suddenly, even the capital is dangerous

Get article background

AP

Not an ornament

IN THE streets of Kabul, the usual maddening traffic has thinned. The many Afghans who were this week commemorating their own national disaster, the murder a year ago of Ahmad Shah Masoud, leader of the only group to hold out against the Taliban, mostly decided that the capital was too dangerous a place to linger in for long. On September 5th, a bomb placed in a crowded area in central Kabul killed at least 25 people and injured another 170. On the same day, President Hamid Karzai narrowly escaped assassination in Kandahar: a gunman who had recently joined the local governor's security forces opened fire on the president's car with a Kalashnikov, missing him by inches. And in the south-east, a renegade warlord is once again making trouble. The past ten days have been a blunt reminder that, although Afghanistan has come a long way over the past year, security remains elusive.

In Kabul, security has been stepped up, with the International Security Assistance Force (ISAF) providing more patrols, and Afghan forces searching cars for weapons and explosives. More than 15 people have been arrested in Kandahar in connection with the assassination attempt on Mr Karzai, but it is unclear whether they were involved. The would-be assassin was shot dead by an American bodyguard. Most earlier crimes, among them the murder of a vice-president and the tourism minister, remain unsolved.

There is no shortage of suspects. Afghan officials have been quick to blame al-Qaeda or the Taliban for the attacks in Kabul and Kandahar, while hinting that Gulbuddin Hikmatyar, an unpopular prime minister in pre-Taliban times, may also be involved. On September 4th, Mr Hikmatyar repeated a call for *jihad*, while denying he had linked up with the al-Qaeda network and the Taliban. Although most people, including the Afghan administration and American defence officials, seem to agree that the Taliban and their al-Qaeda protégés are no longer an organised force in Afghanistan, they can still destabilise the fragile Afghan government through attacks on well-chosen targets. American intelligence officials claim, according to reports, that al-Qaeda fighters who fled to Pakistan are moving back into Afghanistan in small groups. Coalition forces have just launched another anti-terrorist operation, optimistically dubbed Champion Strike, in Paktika province.

But some in Afghanistan, among them diplomats, soldiers and aid workers, believe that political rivalry may be at the root of many recent incidents. Mohammed Fahim, the powerful Tajik defence minister, is said to be under pressure to lessen his grip on the country's security apparatus, and in particular, the National Security Directorate (NSD), the secret police. Security scares have been frequent in Kabul. Many preceded last week's carnage. Continued worry over security is clearly in the NSD's interest and will be an argument against lessening its powers. Many Afghans marvel at the fact that NSD officers always seem to be present at the scene of incidents before ISAF soldiers arrive.

Mr Fahim has staffed the NSD with fellow Tajiks, a tribe from the north, to the displeasure of the southern Pushtuns, the largest ethnic group in Afghanistan and its traditional rulers. Some believe the attempt to kill Mr Karzai may have been motivated by such grievances.

Then there is the problem of the warlords, wrestling for regional control. On September 8th, fighting

flared in Khost, where Pasha Khan Zadran, a warlord who has been supporting the coalition's military operations locally, is now trying to establish control over the region. He was appointed governor of south-eastern Paktia province last December, but was unable to take office there after the local population made it clear his past was too shady for their taste. Another governor was then appointed. Mr Zadran moved to neighbouring Khost, where he has been challenging its governor, Hakim Taniwal. In recent clashes 15 people have died and over 50 have been injured. Mr Zadran denies he has retreated to the mountains and says he is still fighting for control of the city.

There is no quick way to secure the country. The United States and other countries are helping the Afghan government to build a national army and police, which will, they hope, bring order to the whole of Afghanistan. In the meantime, Mr Karzai has repeatedly asked for ISAF to be expanded beyond Kabul. After insisting for months that there was no need for this, American defence officials are now saying they would welcome such a move. A permanent presence in the main Afghan cities, or a mobile force based in Kabul, would not turn Afghanistan into a haven of peace, but it would certainly help. But while America now goes along with the idea, it will not provide any troops. According to Victoria Clarke, speaking for the Pentagon, other countries will have to come up with the necessary.

The problem, however, is how to find volunteers. On September 8th, Francesc Vendrell, the European Union's envoy to Afghanistan, declared that the expansion of the peacekeeping force outside Kabul was “virtually impossible at the moment” because European governments do not have the resources. For now, it is even unclear who will take over after Turkey, which currently heads the 4,700-strong force, completes its mandate in December.

Meanwhile, there is Mr Fahim and his ambitious secret police. A western diplomat in Kabul reckons that he is a real enemy of peace. The diplomat accepts that you have initially to work with the enemy. “For the coalition to fight the Taliban, you need the help of warlords and Fahim. But this is not good for the long- or even medium-term stability of Afghanistan.”

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Australia

Saved by the backpackers

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While tourism slumps, the young still travel

AFTER Sydney staged the Olympic Games to acclaim two years ago, Australian business leaders sat back to wait for the tourism boom they believed must follow. They are still waiting. Their anxieties were heightened last week when Joe Hockey, the tourism minister, chided the industry for failing to capitalise on the Olympics publicity. The number of international tourists coming to Australia had fallen by 10% over the past year, he said, a loss of A$2 billion ($1.1 billion). Many tourists are choosing to go instead to places such as Canada, Singapore and, most gallingly, Botswana.

The downturn is particularly worrying because tourism has come to be seen as one of the economy's big hopes. Twenty years ago, it was of little importance. Australia's distance from the rest of the world, and vast distances within the country, made it an exotic place out of most people's reach. Then came the opening up of locations such as Kakadu National Park in the Northern Territory and the rainforests of north Queensland, the boom in adventure travel and “ecotourism”, and the growth of Sydney as a world-class city. The deregulation of the economy and its exposure to globalisation forced Australians to diversify. Selling the country as a tourist destination became a frontier industry. Tourism is now the fourth-biggest export earner.

Tourism slumped worldwide after the terrorist attacks of September 11th last year. The collapse three days later of Ansett, one of Australia's two main airlines, temporarily cut off connections to some outback destinations. But Mr Hockey blames the tourist industry itself for much of the downturn. Botswana, he says, has proved more competitive than Australia at marketing itself as an adventure destination. But in Sydney some shopkeepers point out that Australia has had bad publicity, particularly in Europe, over the federal government's detention of asylum seekers in outback camps. It suggests an Australia far different from the easygoing, welcoming country of the Olympics period.

Still, there are the backpackers, who continue to flock down under in a big way. They stay months rather than weeks and spend their last dollar. Brigid Flynn, manager of the Biltmore on Bondi, a backpacker hotel facing Australia's most famous beach in Sydney, says her biggest worry is not falling numbers but a growth of illegal backpacker hostels poaching her customers. “People of 19 or 20 years aren't rattled by images of September 11th or imprisoned asylum seekers,” she says. “They just travel.”

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North Korea

Escape to the South

Sep 12th 2002 | SEOUL
From The Economist print edition

The long and dangerous route to safety

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A YOUNG North Korean who had escaped to China wrote to Chun Ki-won, a South Korean missionary, to say he was thinking of setting fire to himself in Beijing's Tiananmen Square. This, he said, would draw attention to the plight of those like him who desperately wanted to get to South Korea. Mr Chun has become known in the Koreas as a man who has worked to provide an escape route from the North to the South. He has risked his life—and has spent time in a Chinese jail—to bring 170 northerners to South Korea by way of Mongolia, Thailand and Cambodia. But many thousands of North Koreans still live in China in fear of being caught and deported back to the North.

Mr Chun persuaded the northerner to scrap his suicide plan and to try to defect to the Ecuadorean embassy instead. But the Chinese authorities learnt of the plan and arrested the northerner and seven of his companions. It is not known what has happened to them. At least Mr Chun may have saved the man's life. In all his years of helping refugees, 46-year-old Mr Chun had never before come across such a threat. But a South Korean government official says that unless the refugee problem is solved, a suicide should not be ruled out.

More than a dozen non-governmental organisations and hundreds of missionaries are working separately to rescue the northerners, and some may be tempted to go for a shock protest to gain media attention. The government official insists that quiet diplomacy is preferable. Nearly all the defectors who have managed to get into the embassies or other foreign establishments in Beijing and other cities have eventually made it to South Korea. Whatever its comradely links to North Korea, the Chinese government wants to be seen as humane, despite reports that it has treated Koreans brutally in border areas. This week 15 North Koreans who sought refuge in a German school in Beijing were allowed to leave for South Korea via a third country, believed to be the Philippines.

In the end, it is the North Korean regime that must ease the refugee problem by reforming its economy. There are signs that it is trying to do that by being flexible over wages and prices and introducing an incentive system at factories and farms. But a free market it is not. Any financial freedom in the country is in the growing black economy, based on dollars, which are never banked but kept at home.

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China

Owning up to AIDS

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From The Economist print edition

A “state secret” is revealed

Get article background

THE government of China said on September 6th that by the end of the year at least 1m of its citizens will be HIV-positive, the condition that can lead to AIDS. Although China has been acknowledging over the past year that it has a problem with the disease, this is the first time it has admitted its extent. The figure is in line with a United Nations estimate in June of between 800,000 and 1.5m.

The epidemic seems to be particularly widespread in the northern province of Henan. In a government report published on the Internet in August by a doctor, Wan Yanhai (who was later arrested for “revealing state secrets”), Henan health officials admitted that state-sponsored “blood stations” had exposed hundreds of thousands of people to the HIV virus. Blood was taken from donors for $5 a bag without suitable safeguards in place, and recycled. This practice, combined with the use of unsterilised equipment, led to an HIV infection rate of 35-45% in some villages in the province.

While the government's new candour has been widely welcomed, there are doubts about China's financial means and technical ability to tackle the epidemic. The country has only 20 or so experts with a knowledge of international experience in dealing with HIV/AIDS. Many more are thought to be needed to devise and implement a useful campaign.

The cost of treatment also remains high. Reports that the government had threatened to produce copies of patented HIV medicines were quickly denied by China. But the government says it has started treating patients with a domestically produced version of AZT, for which patents recently expired, and that ten Chinese firms have applied for permission to make versions of other HIV drugs with expired patents.

A modest five-year nation-wide plan was set up last year, designed to combat AIDS by focusing on prevention, and improving the safety of donated blood. But two AIDS researchers, Joan Kaufman and Jun Jung , authors of a report on the disease in *Science*, an American magazine, argue that the fight against AIDS in China should take place primarily at a local level. Provincial officials have tended to play down the spread of the disease for fear of losing foreign investment, and have been complicit in private blood collection. Students currently receive little formal sex education beyond advice to abstain, and have limited access to reproductive health counselling and services. Public understanding of the nature of the virus, and how it is spread, is limited.

A survey conducted by a newspaper in the southern province of Guangdong found that even in a prosperous part of China, almost half of those aged 20-64 did not think that condoms protected against AIDS, and more than half the respondents thought that it could be contracted through sneezing and shaking hands. Given such misinformation, China will need to work hard to catch up with one of the world's biggest medical problems.

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Vietnam

Corruption abounding

Sep 12th 2002 | HO CHI MINH CITY
From The Economist print edition

The issue that could undermine the government

THE Vietnamese have never seen anything like it: more than 100 government officials arrested, some 50 police officers suspended from duty, and two members of the all-powerful Central Committee expelled from the ruling Communist Party. It is hard to find an official in Ho Chi Minh city, it seems, who was not in cahoots with Nam Cam, a local crime boss. Over the past eight months, a much-publicised investigation has implicated public prosecutors, prison wardens and journalists, among others, in the gangster's drug, prostitution and protection rackets. The arrests are proof, say Vietnam's rulers, that they are serious about fighting corruption, which has spread since the introduction of market reforms in the late 1980s. In fact, the government's attitude is not so clear-cut. But the scandal certainly is proof of how widespread corruption has become, and how hard it will be to uproot.

Transparency International, a global counter-corruption watchdog, ranks Vietnam as the second most corrupt country in South-East Asia (after Indonesia), based on a survey of international businessmen. The Vietnamese government itself recently estimated that light-fingered bureaucrats cream off at least 20% of infrastructure spending. At the National Assembly in July, the prime minister, the speaker, and the secretary-general of the Communist Party all identified corruption as one of the government's main challenges.

With good reason: ordinary Vietnamese gripe about corruption far more often than they do, say, about the regime's restriction of political freedoms. It is the chief rallying cry of dissidents, and the most frequent cause of popular protests. The party's chief ambition, now that it has abandoned Marxism, seems to be the maintenance of its own power. Public disenchantment brought on by corruption is one of the biggest threats to that cause.

Yet the regime's response so far, whatever its public stance, seems half-hearted. Suspicions persist that the Nam Cam affair might go even higher than the two Central Committee members—but the investigation will not. There is no reason to imagine that Ho Chi Minh is the only big city with greasy-palmed apparatchiks, but there is no sign of a crackdown elsewhere. A deputy prime minister, sacked for corruption in 1999, is back in an advisory role. Proposals for legal reform will take years to implement. The cautious government still allows only a summary of its budget to be published, and is even dragging its feet over a proposed survey, to be paid for by a Swedish government agency, to establish just how widespread corruption is.

The cynical explanation for all this holds that the government is simply doing the minimum to dispel public anger. More charitable observers insist that it is genuinely determined to tackle corruption, but in the same cautious, consensual manner with which it has approached every sensitive subject from the adoption of market reforms to the restoration of ties with the United States. Those two steps, however, pandered to the interests of senior officials—many of whom have businesses on the side—by expanding the scope for private enterprise. This time around, the opposite is the case: the same officials who commit many of the abuses will now be charged with putting a stop to them. Appointing an independent anti-graft agency would be anathema to the party, which insists on preserving a parallel bureaucracy to enforce its will over the main one. On corruption as with all pressing issues, the party faces the same paradox: to preserve its power, it must relinquish some.

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Arabs and America

In America we do not trust

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From The Economist print edition

Arabs intensely dislike American policy. But this doesn't mean they will defy it

AP

AMERICANS think we should be more like them, goes a bitter joke currently consoling Arabs, but every day they look more like us. They have a hereditary presidency, corruption, terrorism, Israeli-occupied territory (Capitol Hill), and a bad record for human rights. Now they want to do to Iraq what Iraq did to Kuwait.

What people find funny is often revealing. One thing this joke illustrates is that in the past year Arabs, even more than before, have come to regard American motives with scepticism (or outright incredulity), and American power with panic. Another is that Arabs have never felt their own failings so keenly.

Disenchantment with America is hardly an Arab monopoly. Yet the erosion of post-September goodwill has been particularly complete in a region that feels it is being condemned collectively for the sins of a few. The looming invasion of Iraq, and the sense that other Arab targets may be next, have further soured the mood.

In its mildest form the attitude is one of simple disappointment. Egypt's foreign minister, Ahmad Maher, laments that America lost a unique chance to rally the world to its side after last year's attacks. It lost the chance by applying the “with us or against us” judgment in pursuit of narrow interests rather than broader principles.

More commonly, Arabs are aggrieved by what they perceive as an American failure to listen to them. Why do they hate us?, Americans ask. They answer the question by persuading themselves that the hostility of the “Arab street”, a hostility that al-Qaeda carried to savage extremes, stems from some kind of cultural envy, made poisonous by the oppressiveness of Arab societies and states.

But, as any simple Arab citizen will confirm, resentment of the superpower has never been a response to America itself. Rather, it is a response to its policies: its throttling of Iraq, sanctioning of Libya and Sudan, and, above all, its generous bankrolling of Israel. “Take Israel out of the equation,” says a businessman in Jeddah, “and, poof, we've basically never had a problem with America.”

To the dismay of America's friends in the Arab world, the perceived tilt against them has grown more extreme in the past year. Countries such as Syria and Yemen have bridled at accusations that they harbour terrorists, whatever the truth of the charges. The lumping of groups such as Hamas and

Hizbullah into the same camp as al-Qaeda has jarred with the Arab view of them as freedom fighters, whose cause, if not always their methods, is legitimate.

Saudi Arabia has been mauled in the American press, and seen its peace initiative ignored. Racial profiling of Arabs by American authorities, and right-wing talk of mounting a “crusade”, or “redrawing the regional map”, and, spectacularly, the praising of Ariel Sharon as a “man of peace”, have all ignited Arab alarm.

Instead of trying to douse extremism, says Raghida Dergham, who reports incisively from New York for a liberal daily, *Al Hayat*, the Bush administration has seemed intent on inflaming it. Her explanation is that American policy has, in effect, been hijacked by a coterie of officials whose obsession with Israeli interests has warped America's whole approach to the region.

Such is the view of a noted moderate, and one privately shared by most Arab governments. But the more popular view is that America is not just being manipulated by Israel, but that it has its own wicked agenda. “What America wants is to dismantle the Arab world,” declared a speaker at a year-after forum in Cairo.

Damascus radio talks of plans to “recolonise” the region. Abdul Bari Atwan, editor of a radical Arab daily, *Al Quds al Arabi*, outlined a scenario whereby Israel would be made “the trusted sentry guarding the oil fields while the Arabs, or what remains of them, revert to rearing camels.”

Such alarmism has triggered calls for a stronger diplomatic response. American bases in the Gulf should be closed, say some. Joint defence pacts should be invoked to protect Iraq, say others, and Arab money withdrawn from America. But while sporadic boycotts of American goods have broken out, the most that a recent gathering of foreign ministers from 20 Arab countries could muster was a resolution calling for “a complete rejection of threats of aggression against some Arab countries, in particular Iraq.”

And that is about as far as official Arab opposition to “regime change” in Iraq is likely to go. Behind the scenes, many governments are signalling acquiescence in America's plans. This is partly in recognition of the limits of their power in the face of American determination. It also reflects frustration with the Iraqi regime, mainly because of its blind stubbornness.

Arab visitors to Mr Hussein have been shocked to find that he really intends to fight, or so he says. In response, the tone of pro-government commentary in countries such as Egypt and Jordan has changed. Baghdad should understand that sympathy for the Iraqi people does not mean that their leadership is liked, or that other Arabs will fight America on its behalf, scolds Cairo's official daily, *Al Ahram*. Jordan will not commit suicide for Saddam's sake, echoes a columnist in Amman.

Quietly, too, another undercurrent of thought is spreading. Arab governments may tremble at the thought that regime change may prove contagious, but a growing number of their citizens think it is maybe not such a bad idea. The exposure of Arab weakness has prompted unusually outspoken criticism, even in such police states as Syria and Saudi Arabia. The gist of the message is that if the Arabs want to be strong, their governments must devolve more power to the people.

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Iraq

Defiance and death

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September 11th, say Iraqis, became an excuse to persecute them ever more

Get article background

Radiotherapy is denied him

SYMPATHY on the first anniversary of the terrorist attacks against New York and Washington was in low supply on the streets of Baghdad. September 11th, say ordinary Iraqis, provided the United States with an excuse to step up its persecution of the Iraqi people. They have come to accept that war with America is inevitable, but their response, at least as proclaimed to a group of journalists, was defiant. Some echoed the bravado of their foreign minister, Naji Sabri: “Even if it is with palm-tree sticks, we will fight back.”

September 11th also made it easier, says Amer Muhammad Rashid, Iraq's oil minister, for the Americans and British on the UN sanctions committee to justify tightening the economic noose round Iraq. One result, he says, is the drop in oil sales over the past four months. This is partly due to the fear of war, but also the new restrictions imposed on the pricing mechanism (to avoid the payment of illegal kickbacks) which mean that buyers do not know until a month later the price at which they are buying Iraqi crude. Iraq now exports under 1m barrels a day through the UN, compared with 1.7m bpd last year.

Tighter rules on imports do visible damage. Six months ago, Ali Asiyan, a nine-year-old leukaemia patient, had a good chance of survival. Today he is very likely to die. This, says Luay Qusha, the chief doctor at Baghdad's Al Mansour paediatric hospital, is because for the past six months the UN has not allowed Iraq to import radioactive agents used to diagnose and treat cancer on the grounds that they could be used to produce “dirty” bombs.

“I want my child to live but the Americans want all Iraqis to die,” said Ali's mother, a gaunt woman swathed in a black chador. Emaciated children sit listlessly on their beds. In another ward are the prematurely born babies, their tiny bodies mangled with deformities. The UN's oil-for-food programme helps, “but only the tiniest bit,” says the doctor, pointing to rows of empty medicine cabinets.

Dr Qusha says the high rate of cancer, premature births and birth defects is chiefly due to the exposure of their parents to radioactive materials left over from the 1991 Gulf war. Health Ministry statistics say that the incidence of abnormal births has increased 400-fold since 1991. The Iraqis also say that, all told, 1.7m children have died because of the various effects of UN sanctions. In the West, the Iraqi government is held to blame for contributing to and manipulating this tragedy.

At the Tuweitha nuclear facility just south of Baghdad, Iraqi scientists who produce chemical agents used for cancer treatment know that they will be among the first targets if the Americans and British launch an attack. They know this, they told correspondents, because the British released a map last week showing satellite images of Tuweitha to support the claim that the Iraqis have resumed producing nuclear materials at the plant.

There is little doubt that it did once. The plant's largest reactor was destroyed by Israeli bombers in 1981. American and British bombs smashed the two remaining reactors during the Gulf war. But since then, or so claim the Iraqis, the site has been clean, and was repeatedly searched by the UN inspectors until they left in 1998.

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Iraq's arsenal

Perhaps

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The IISS's assessment

Nuclear / radiological

• Does not possess facilities to produce fissile material in sufficient amounts for nuclear weapons.

• Would require at least several years and extensive foreign assistance to build such fissile material production facilities.

• Could probably assemble nuclear weapons within months if fissile material from foreign sources were obtained.

• Current interest in radiological weapons unknown. Could divert domestic civil-use radio-isotopes or seek to obtain foreign material for a crude device.

Biological

• Probably retained substantial growth media and agents from pre-1991 stocks.

• Capable of resuming agent production on short notice (weeks) from existing facilities; could have produced thousands of litres of anthrax, botulinum toxin and other agents since 1998. Actual stocks unknown.

• Production of viral agents, possession of smallpox unknown.

Chemical

• Probably retained mustard and precursors for a few hundred tonnes of sarin/cyclosarin; perhaps similar amount of VX from pre-1991 stocks.

• Capable of resuming production on short notice (months) from existing civilian facilities; could have produced hundreds of tonnes of agent (mustard and nerve agents) since 1998. Actual stocks unknown.

Delivery means

• Probably retained a small force of 650km (400 mile) range al-Hussein missiles, perhaps around 12 missiles.

• Lacks facilities to produce long-range missiles, would require several years and extensive foreign assistance to construct such facilities.

• May have produced some al-Samoud missiles, with ranges up to 200km.

• Capable of manufacturing rudimentary chemical and biological warheads.

• Capable of converting civilian vehicles to mobile launchers.

• Capable of delivering biological weapons with simple airborne wet-spray devices; development of more advanced devices for wet spray or dry agents unknown.

Source: The International Institute for Strategic Studies

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Namibian land reform

Talking like Mugabe

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But Namibia's Sam Nujoma is not as reckless as he sounds

IT ALL sounds worryingly familiar. Sam Nujoma, Namibia's grizzled old president, who has ruled since independence in 1990, last month berated “arrogant” commercial farmers for blocking land reform. He said, not unreasonably, that Namibians were angry that a few thousand white farmers still control 36m hectares (89m acres). This is 70% of the country's privately-owned land, and 44% of its total land mass.

He says that he wants to expropriate 192 farms, mostly owned by Germans and South Africans, and adds that unless the owners co-operate, Namibia will go the way of Zimbabwe. Last week, at the UN development summit in Johannesburg, Mr Nujoma emphasised his point by cheering Robert Mugabe, blaming Britain for Zimbabwe's woes and declaring, disingenuously, that Africa does not need western investment.

His words grabbed the headlines. But even though Mr Nujoma and Mr Mugabe are close allies, few expect Zimbabwean troubles in Namibia, or anyhow not just yet. Unlike Mr Mugabe, Mr Nujoma does not feel threatened by his feeble domestic opposition, so he does not need to use land reform as an excuse to crack heads. Diplomats in Windhoek argue that Mr Nujoma's frequent outbursts belie his government's moderate policies. He often rants against homosexuals, for example, but has done little to persecute them.

This week, Mr Nujoma's new prime minister, Theo-Ben Gurirab, said that the government would continue to acquire land for redistribution mainly from willing sellers. By law, it has first refusal on any farm for sale, and pays market prices. Although the process has so far led to the resettlement of only 100 farms, this is partly because of the difficulty and cost of teaching former cow-herders to manage enormous and sprawling ranchland effectively.

It will take time, and aid money for irrigation, roads and equipment, for any of these resettled farms to become self-sustaining. More may have to be done to support farmers once they have land, for example by granting cheap “affirmative action” loans to new black farmers.

The Namibian Agricultural Union (NAU) is not braced for great upheavals. Next year, the government plans to introduce a small tax on under-used farms, to encourage more farmers to sell plots. According to Gert Grobler of the NAU, Mr Nujoma's plan to expropriate farms will probably lead to the forced purchase of only “one or two” unproductive farms now owned by foreign, absentee landlords, and used as hunting grounds. As for Zimbabwean-style land invasions: “Forget it. Anyone who invaded a cattle ranch would soon die of thirst,” he scoffs.

But some individual commercial farmers are more anxious. This week, over 150 of them gathered at a ranch in eastern Namibia for a sundown bull auction and party. Between mouthfuls of cake, they grumbled about official meddling, the failure of farms resettled by poor black workers, and the risks to investment whenever the “old man” shoots his mouth off. A Scottish speaker then explained how to use God's love to fend off land-invaders.

The farmers' greatest worry is that land reform is becoming a political issue. Elections are due in 2004. The popular Mr Nujoma has promised to step down, but could always change his mind. If he does, he will have to convince his party to carry on backing him. Inequitable land distribution could give him an excuse to stay on, to finish the job of liberating Namibians from white domination.

In the meantime, he could do something useful in northern Namibia, the wettest and least sparsely populated part of the country, where demands for land reform are strongest. People there want jobs or,

failing that, secure tenure on small plots of arable land near home. The government could provide this by redistributing some 8m hectares of state-owned land.

“Land reform in these communal areas is the key issue for poor farmers,” says Dirk Hansohm, an economist in Windhoek. Donors would happily finance resettlement on such lands. But Mr Nujoma is not particularly interested. Why? Perhaps because none of those arrogant white farmers has a plot in the north.

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Oil in Chad

Useful stuff, maybe, for once

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A novel scheme to extract oil without fuelling corruption or bloodshed

ALMOST every African nation blessed with copious minerals is also cursed with some form of civil unrest. Rebels, regular armies, and sometimes foreign armies too, slug it out for control of oil or diamonds. Nor does natural wealth promote good governance. A regime with oil is less accountable to ordinary citizens; it does not have to collect their trifling taxes or meet their tedious demands. A portion of the petrodollars must be spent on the army to keep the masses in line, but the rest can be split among the political elite.

But not, it is now hoped, in Chad, where the World Bank has devised a new scheme to ensure that oil profits are spent wisely. The stakes are high: a consortium led by ExxonMobil has just started pumping oil in the country's Doba basin, and the government's oil revenues are expected to reach $80m-$140m after 2003. What is novel about the plan is that the consortium will not pay the money directly to the Chadian government. Instead it will go into an offshore account. To get it, the government will require consent from an independent committee, which has to co-sign all cheques, and will do so only if the government spends the money on health, education or basic infrastructure.

The World Bank sees the scheme as a model for how oil firms can function in unstable parts of Africa. Many are eager to diversify out of the Middle East, and so have an eye on Africa's vast untapped reserves. In the past, firms have tended to make under-the-table deals with corrupt African leaders and then claim that, as private companies, they cannot be held responsible for how the governments they bankroll spend the cash. It is not an absurd argument—no oil firm has the power to bring peace to Sudan or to clean up Nigerian politics. But under pressure from activists, some companies are trying to exert a bit of influence. BP, for example, tried last year to promote transparency in Angola by revealing how much it paid to the thoroughly corrupt government there.

In Chad, ExxonMobil agreed to work with the World Bank, and to submit to its stern demands for transparency and accountability. It thus hopes to placate environmental and human-rights lobbyists, who have been loudly critical of the project. ExxonMobil says that its pipeline, which stretches 1,000km (600 miles) through virgin rainforests to the coast of Cameroon, is the largest-ever private infrastructure investment in sub-Saharan Africa, costing $3.7 billion. The oil company, which faces plenty of risks on the ground in Chad, does not want the pipeline to become a global public-relations disaster.

Even before they had oil to fight over, Chadians had been at war with one another almost constantly since independence from France in 1960. Hissène Habré, a president of Chad in the 1980s, tortured and killed tens of thousands of his own people, stopping only when overthrown, in 1990, by General Idriss Déby. Mr Déby is still in charge, having rigged a presidential election last year. His government and army are dominated by Muslim northerners, mostly from his own tribe.

Better than fighting each other

Various groups continue to rebel against the regime, but fighting in the Christian and animist south, where the oil is, has eased since 2000, when the army killed the main southern rebel leader. Southerners are still fractious, but now direct their complaints mostly at the oil firms. The arrival of hordes of well-

paid expatriates has caused prices of basic goods to soar to levels many locals cannot afford. The oil firms do provide jobs, but only about 3,000 of the 10,000 workers on the project are Chadians, and most will be laid off when the pipeline is completed next year. In the meantime, schools are finding it harder to function because teachers are taking better-paid jobs with the oil company. There are frequent strikes as well as reports of sabotage.

ExxonMobil is spending $8m to compensate those living along the pipeline and has agreed to a slew of social and environmental conditions set by the World Bank and others. Environmentalists still complain that the pipeline will damage the Cameroonian rainforest, and other worries remain. The pipeline will be able to withstand a fair amount of unrest, not least because it is being laid underground.

But many doubt the government's good intentions. Its first taste of oil money, in 2000, was spent largely on arms. Mr Déby's excuse was that he was facing a fresh rebellion in the north. Were a rebellion to occur in the future, a little-discussed clause in the revenue-sharing agreement would allow him, once again, to splash out on weaponry. Even so, the World Bank insists that Chad, unlike its neighbours, will put the bulk of its oil windfall to better use. “Chad has to be different,” says one World Bank official, “because we're staking our reputation on it.”

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Angola

Rebels in search of house and job

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The war is over, but what can be done with all the ex-rebel soldiers?

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HOME improvements are all the rage in Sambo, a “quartering area” for former UNITA rebels in central Angola. Ex-guerrillas are mud-plastering their huts, using strips of bark to weave patterns into the walls. It beats living in the bush, where most have spent the past two decades. And some, after years of looting, have turned to honest trade. A makeshift shop sells home-made flour sieves, a few pairs of corduroy trousers, and a single pink bottle of hand lotion.

The camp at Sambo is one of many. Since April, when the government made peace with an all-but-defeated UNITA, 35 have been set up, to ease the rebels' reintegration into Angolan society. About 5,000 UNITA soldiers and officers are to be given posts in the Angolan army. The remaining 80,000 are now officially civilians but, in practice, they still take orders from UNITA functionaries, and have an unknown quantity of weapons stashed away.

They are supposed to have surrendered their guns to the government, but officials will not say how many have been received. The tallies from individual quartering areas give some clue: for every four soldiers, an average of less than one weapon has been handed in. Officers claim this is because so many were “lost in the bush”. This excuse is less lame than it sounds. UNITA was in disarray by the time its leader, Jonas Savimbi, was killed in February, thereby precipitating peace.

For now, Angola is enjoying a post-war honeymoon. Ancient lorries and donors' jeeps shuttle between the country's shattered towns, dodging potholes but no longer fretting that they might be ambushed. How long will peace last? Only as long, some drivers fear, as the demobilised rebels believe that the government will give them what it has promised: vocational training, and help back into civilian life.

The regime has enough money to keep its promises, but lacks the necessary know-how and political will. It plans to close the quartering camps next month, and send the former guerrillas back to their long-abandoned home villages. Aid workers fear that this could leave many of them destitute, hungry and restless.

The United Nations is trying to help. It serves as a giant soup kitchen for 4m displaced people, and also, recently, for the 300,000 residents (rebels and their families) in the quartering areas. The government would probably prefer that it limited itself to such uncontroversial charitable activities. But the UN still has other tasks.

On August 23rd, the government and UNITA agreed to implement, under the UN's watchful eye and within 45 days, the terms of an earlier peace deal, under which UNITA was to stop fighting in return for a clutch of cabinet posts and ambassadorships. UNITA wants to keep the UN involved for as long as possible, to prevent the government from pushing it around. The rebel group claims to be penniless, having lost control, it says, of the diamond fields that used to finance its guerrilla war. Some of its leaders are doing well, though: at least one UNITA general has formed a joint mining venture with an old adversary from the army.

After the 45 days are up, UN staff are uncertain how much influence they will continue to wield. Elections are scheduled for 2004, but as things stand, Angola remains, in effect, a one-party state. Opposition parties are splintered and harassed. Most of the media are state-controlled. Ruling-party flags fly over the camps where the UN distributes food, with the sole exception of the UNITA quartering areas. And these are soon to be closed.

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Germany's foreign policy

Why Gerhard Schröder has gone out on a limb

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From The Economist print edition

For the first time since the second world war, Germany's foreign policy is distinctly at odds with America's

Get article background

UNTIL recently, Germany was one of the United States's best friends. The Americans could rely on its enthusiastic moral, if not military, support in most global matters. Within hours of the terrorist attacks on the United States a year ago, Gerhard Schröder, Germany's chancellor, was among the first to pledge his "unlimited solidarity", describing the event as "a declaration of war against the entire civilised world". But now he has categorically rejected any German support for an American-led attack on Iraq, even if backed by a United Nations mandate. The relationship that has been the cornerstone of German foreign policy since the second world war is under severe strain. Though several European governments feel much the same towards Mr Bush's policy, Germany's has gone furthest out on a limb.

What has happened? Over his four years as chancellor, Mr Schröder has presided over democratic Germany's coming of age in foreign affairs. He courageously led his country into its first armed conflict (in Kosovo) since the second world war, then into its first war outside Europe (in Afghanistan), on both occasions risking his government's downfall. "The days when Germany could stand timidly on the sidelines, declining to participate in foreign military missions, are irrevocably over," the chancellor declared after last September 11th.

Until now, Mr Schröder has always been very firm that Germany would never act on its own. But suddenly he is talking of a new "German way" in foreign policy, with echoes—alarming to some—of Germany's *Sonderweg* (special way) in the 1930s. This worries quite a few of Germany's friends. It is not just what Mr Schröder has said about the United States and Iraq, but also the way he has expressed it. Germany, he declared, rejected any American military "adventures" in Iraq. While willing to help press Saddam Hussein into letting UN weapons inspectors back into Iraq, Germany was not prepared "to play around" with war.

Edmund Stoiber, the conservative challenger for chancellor, has been more nuanced, accusing his rival of sacrificing Germany's ties with its most important partner for electoral gain. Mr Schröder's Social Democrats are running neck-and-neck against the Christian Democrats in the run-up to the general election on September 22nd. Every vote counts. Whereas a large majority of Germans backed the war against al-Qaeda in Afghanistan after September 11th, most, especially those on the left, are dead against one with Iraq. At campaign rallies, Mr Schröder and Joschka Fischer, his Green foreign minister, always get the loudest cheer for their stand on this issue of "war and peace".

Germans are not anti-American. They admire many facets of American life, share most basic values, and generally regard the United States as their key ally. But Mr Bush's administration is not getting a good German press. The list of gripes is long: many Germans deplore Mr Bush's hostility to the International Criminal Court; his attitude to the environment; the death penalty; unfettered American support for Israel against the Palestinians; genetically modified foods; farm subsidies; the Americans' apparently growing unilateralism; and now its policy on Iraq. At home it does Mr Schröder no harm to be bravely standing up to the perceived American bully.

It would be wrong to dismiss his stance as pure vote-catching. He and many other Germans think an attack on Saddam Hussein would be an error. Earlier this month Mr Schröder told the *New York Times* that he was not convinced that Mr Hussein posed an immediate threat. A strike against Iraq, the chancellor argued, would unsettle all of the Middle East, destroy the international coalition against terror built up after September 11th, and perhaps even push the Iraqi dictator into the very rapprochement with Islamic extremists that the United States fears. Moreover, he says there has been no American effort to analyse the consequences of such an attack nor to plan any clear strategy thereafter.

Mr Schröder and many other Germans think an attack on Saddam Hussein would be an error

He singled out what he claimed was America's “change of strategy” at the end of August, when the vice-president, Dick Cheney, said that the Americans' aim was to overthrow Mr Hussein, not just to get the UN's weapons inspectors back in. “How can you exert pressure on someone by telling them that, even if you accept our demands, we will destroy you?” he aske'd. He was miffed, too, by lack of consultation. “It just isn't good enough to learn from the American press about a speech which clearly states: ‘We are going to do it, no matter what the world or our allies think’. That is no way to treat others,” he said.

Above all, Mr Schröder rejects America's claimed right to pre-emptive action against Iraq. On this score he is not alone among Europeans. France's president, Jacques Chirac, has called Mr Bush's doctrine “extremely dangerous”. German diplomats echo Mr Chirac's argument that other countries might demand a similar right to pre-emptive action: India against Pakistan, for example, or China against Taiwan. “A few principles and a little order are needed to run the affairs of the world,” Mr Chirac explained, to German nods of approval. But, unlike Germany, France has not ruled out the possibility that it might take part in a attack against Iraq, provided the UN approves.

Germany is the only member of NATO or the EU to have done so. Asked in a televised debate with Mr Stoiber last weekend whether he might change his mind about Iraq after Germany's election, Mr Schröder said categorically that he would not.

With his brash megaphone diplomacy, Mr Schröder seems to have painted himself into a corner from which it will be hard to unstick himself without looking silly. If the Americans do hit Iraq without German support but with Britain, France and others alongside, Germany could find itself summarily dismissed from its new hard-won place at the top table of nations.

Mr Stoiber, meanwhile, is still hedging his bets. He says he won't rule out “any options”, but at the same time says he does not want “any military measures and certainly not with German participation”. He, too, is mindful of votes. But once war begins, he is a lot more likely to fall into line behind the Americans. If Mr Schröder remains chancellor, he may have a hard time rebuilding the transatlantic bridge.

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Austria's collapsing government

Back to square one

Sep 12th 2002
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After the collapse of Austria's right-wing coalition, what next?

Reuters

Can Haider be restrained forever?

THE fall this week of Austria's first purely right-wing government for three decades may well mark the end of the political road for Wolfgang Schüssel, the country's chancellor for the past two-and-a-half years and leader of the mainstream conservative People's Party. It is unlikely, however, to curb the ambition of Jörg Haider of the populist Freedom Party, the outgoing coalition's second strand, to win the country's top job some time in the future. Meanwhile the Social Democrats, who have run Austria for most of the past century, usually as the main partner in various coalitions, seem likely to come back into power by the turn of the year.

What has Mr Schüssel, who was vilified by the left at home and abroad for ditching the Social Democrats and bringing the Freedomites into his coalition, achieved? For one thing, he had hoped to cut his right-wing rivals down to size, by forcing them to drop their xenophobic populism once they were locked into power. He had also hoped to tame their rabble-rousing leader, Mr Haider, who was formally made to opt out of national politics and retreat to the governorship of the southern province of Carinthia, a job he already had as his party's national boss. That was the price the Freedom Party had to pay for joining Austria's government.

Mr Schüssel probably succeeded in his first aim. The Freedom Party has slumped in the polls from the 27% that it won in the last general election, in late 1999. But he has plainly failed to emasculate Mr Haider. The 52-year-old maverick continued to call many of the shots within his party from his southern Alpine redoubt. It was when his party colleagues, such as Susanne Riess-Passer, who had become the country's vice-chancellor and the party's formal leader, and young Karl-Heinz Grasser, who became finance minister, refused to do Mr Haider's bidding that rows broke out in their party. These eventually, this week, led to the coalition's collapse.

Until then, the centre-right-cum-hard-right coalition had chalked up a number of gains. Last year it just about managed to balance the budget. It negotiated compensation for victims of the Nazi period during Austria's union within the German Reich under Hitler. It also enacted some necessarily painful reforms that the previous Social Democratic-led coalition had funked. For instance, it raised the retirement age, changed the system of severance pay that had impeded job mobility, and made university students pay for part of their tuition. And it further weakened the old patronage system of *Proporz*, whereby many public-sector jobs, from drivers and janitors to head teachers and diplomats, were carved up between members of the two main parties.

Still, the Freedom Party also prevented Mr Schüssel's lot from enacting various other reforms, such as the liberalisation of shop-opening hours. And it forced the government to increase Austria's already generous allowance for parental leave. In most respects, however, the government did not seem particularly in hock to the populists. The outrage expressed by many other European Union governments when the coalition took power has for the most part looked misplaced.

But it was precisely the new-found respectability of the Freedom Party's people in government that began to niggle Mr Haider, especially as his party's popularity, based largely on protest in opposition, started to slide. While Mrs Riess-Passer stopped listening to him, sounding sensible and moderate on a visit this year to the United States, he resorted to his rebellious old ways by flying off twice to see Saddam Hussein in Iraq and having cosy meetings with Belgium's ultra-nationalist nasties. He accused

Mrs Riess-Passer of being “duped” by her coalition partner and then engineered a party coup that forced her and three of her closest Freedom Party colleagues in the government to resign. Mr Schüssel ended the rumpus by calling a general election that will probably be held in November or early December.

Being the junior partner in a moderate government had weakened the appeal of Mr Haider's party to its core constituency, disgruntled blue-collar workers and others, such as small farmers and shopkeepers, who feel threatened by modernisation. Hence Mr Haider's decision to adopt his old posture as opposition leader. He had balked at the coalition government's decision to put off tax cuts to pay for recent flood damage. Most notably, he has noisily recanted his party's enforced and grudging support for the expansion of the EU to take in countries to the east.

But Mr Haider is unlikely to win back all the support his party lost by joining the government. In any case, he must first regain his grip over the party at what is likely to be a rowdy gathering later this month. After re-establishing himself as the opposition's main leader, he probably hopes to have another serious shot at the chancellorship in, say, 2006.

The latest opinion polls put the Social Democrats well ahead in today's field, with around 35% of likely votes. Mr Schüssel's People's Party stand at around 29%, Mr Haider's Freedomites at less than 20% and the Greens at about 12-14%. If the two big parties do, as usual, come out on top, Mr Schüssel is unlikely to stay on as chancellor. The Social Democrats' Alfred Gusenbauer is tipped to lead a new coalition, either with the People's Party or the Greens. Though only 57, Mr Schüssel would probably bow out as his party's leader. But Mr Haider will probably stay on his perch, preaching populism, occasionally pandering to xenophobic prejudice, and waiting for another chance.

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France's illegal immigrants

A new balance

Sep 12th 2002 | PARIS
From The Economist print edition

France's new government is trying to create a “balanced” immigration policy

AP

My papers, please

HOW many illegal immigrants reside in France? Whatever the true figure—200,000 to 400,000, according to various estimates—they have been enough to discomfort a string of governments by demanding the right to stay. In 1991, for example, a group of unsuccessful Kurdish asylum-seekers embarrassed the Socialists with hunger strikes; in 1996 the centre-right government of Alain Juppé sent in riot police to dislodge 300 Africans, mostly from Mali, who had sought refuge in a Paris church. And now comes the turn of the centre-right government of Jean-Pierre Raffarin: thousands of illegals have greeted its return from holiday with a series of street demonstrations in Paris and other cities—and another is promised for September 28th.

All of which could mean a nasty political headache not just for Mr Raffarin but more particularly for his interior minister, Nicolas Sarkozy: a hard line would alarm those many French citizens who take human rights seriously; a soft line would give ammunition to an extreme right whose presidential candidate, Jean-Marie Le Pen, last April got more votes than Lionel Jospin, the Socialists' then prime minister.

Hence, last week, Mr Sarkozy's careful choice of words: “France needs immigrants, but France cannot and should not welcome *all* immigrants.” As the minister went on to argue, immigration is an issue all too often taken “hostage” both by the “fanatics of zero immigration, which is a nonsense given that France is built on its diversity” and by liberal “extremists” whose call for automatic legalisation would only breed xenophobia. In other words, France must have “a balanced policy, without pretence or hypocrisy”.

No hypocrisy? For sure, France does need immigrants. Southern wine-makers and fruit-growers, for instance, complain that they cannot get enough workers, despite jobless rates of over 9% of the workforce, while United Nations statisticians say that France would need 1.7m immigrants a year to maintain its demographic status quo. In accordance with European Union policy, however, the country does its best to keep out non-EU migrants. Meanwhile, thousands are smuggled in from Africa, the Middle East and Asia to swell the ranks of the *sans-papiers*—those who have no identity papers to give them a right to residence.

Once arrived, illegal immigrants are unlikely to leave. That holds true even of the minority who are arrested. In 2000, for example, some 43,739 foreigners were given their marching orders, but only 9,230 were expelled. In 1996, when the right was cracking down, some 28,000 foreigners with the wrong papers or no papers were arrested in Paris—but 22,000 were quickly released and only 1,700 left the country.

So what will Mr Sarkozy's balanced policy amount to? Though there will surely be no blanket legalisation of the kind advocated by Jack Lang, a former Socialist minister, to end “inhumane and absurd situations”, a great many of the *sans-papiers* will probably get their papers, and perhaps sooner rather than later. One reason is that Mr Sarkozy, saying the authorities previously acted with “excessive administrative zeal”, is setting a new tone. The police chief of Paris, for example, now promises to look “case by case” at demands for legal status, and to do so with “pragmatism and humanity”.

The second reason is that the rules have already proved flexible enough to allow for such pragmatism and humanity: of the 140,000 foreigners who sought to “regularise” their status when the left came to

power in 1997, some 80,000 succeeded. Marriage to a French citizen; children born in France; severe ill-health; “personal or family links in France”; or simply residence, albeit illegal, in France for ten years or more: all these can give a *sans-papier* the right to reside. As long as the civil servant making the decision did not vote for the immigrants' foe, Jean-Marie Le Pen.

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Sweden's coming election

Unusually tight

Sep 12th 2002 | MALMO
From The Economist print edition

Sweden's leader is having to fight harder than expected to keep his job

A MONTH or two ago Goran Persson was on cruise control. Buoyed by a purring economy and personally popular, Sweden's Social Democratic prime minister looked comfortably set to win a general election on September 15th. Yet in a few weeks, his aura of invincibility has waned. Pollsters say that a four-party alliance led by the Moderate Party, as Sweden's conservatives are known, could yet get as many votes as the likely combined tally of Social Democrats, Greens and the Left, as the ex-communists are called. But the odds still favour Mr Persson to stay in power at the head of his minority government, which includes the Greens and relies on a pact for votes in parliament with the Left.

Mr Persson's stolid election campaign has smacked of complacency, while the Moderates, together with the free-market Liberals, the Christian Democrats and the rural-minded Centre Party, have waged an energetic crusade calling for sweeping tax cuts and better-run welfare services. That the quartet can even dream of an election victory owes much to the revitalised Liberals. Six months ago they looked hard pressed to get the minimum 4% of the national vote to win any seats in parliament, but the latest opinion polls give them around 13%, making them the third party after the Social Democrats, on around 36%, and the Moderates, on 20% or so.

The Liberals' renaissance began when their leader, Lars Leijonborg, said that immigrants should have to pass a Swedish language test before getting citizenship. Integrating immigrants is an increasingly vexed issue. Unemployment among newcomers is high and the growth of ghettos outside the country's main cities worries many indigenous Swedes. While the main parties have largely steered clear of the issue, Mr Leijonborg touched a raw nerve.

Unfortunately for the combined conservative opposition, the Liberals' gains are partly at the expense of their allies, in particular the Moderates, who are predicted to fall short of the 23% share of the vote they won in the last election, in 1998. The non-socialist block probably needs an outright majority of seats to oust Mr Persson. That still looks beyond its reach.

Moreover, many Swedes are sceptical about the alliance's plan for tax cuts, in particular the mammoth package suggested by Bo Lundgren, the Moderates' leader, who promises to reduce taxes by SKr130 billion ($14 billion) over four years, if elected. He says he would save SKr80 billion by cuts in the public sector, though he has yet to identify where exactly he would wield the axe. He would save the other SKr50 billion, he says, by generating higher growth through lower taxes.

Mr Lundgren says Sweden's taxes, which are the highest of all countries in the OECD, foster an anti-enterprise culture. He points to several big Swedish companies that have moved their headquarters abroad as evidence that high taxes are harming business and stifling job creation.

But many Swedes, not just on the left, fear that big tax cuts would hit welfare. This week his supposed allies—the Liberals, the Christian Democrats and the Centre Party—all implied that Mr Lundgren's plans were too radical. Mr Leijonborg bluntly labelled them “unrealistic”.

In any event, Mr Persson, who took office in 1996, can cite a fair record. Since 1999, Sweden's economy has grown by nearly 4% a year. This year it may swell by only 1.9%, but that is above the EU average. Inflation is running at 2.2%, unemployment has dipped to 4.3%, interest rates are low. Consumer spending is perky, despite a bearish stock market and big problems at Ericsson, the telecoms company that is Sweden's biggest private-sector employer.

Mr Persson has deftly handled his minority government in parliament. Most Swedes consider him reliable

and decent. Still, if the election result is tight but he still comes out on top, he may find the Greens and the Left unusually tricky. They are both hostile to European integration and argue against joining the euro, which Mr Persson wants Sweden eventually to embrace. Now both groups say they must have posts in the cabinet. Mr Persson is against that too. Even if he wins, he will face an awkward autumn.

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A Spanish wedding

End of an era?

Sep 12th 2002 | MADRID
From The Economist print edition

Was the grandeur of the wedding of the prime minister's daughter a mistake?

AP

Daddy has a lot of friends

A TELLING error of judgement by a politician losing touch with reality, or a proud father doing his best for his beloved only daughter? Spaniards differ over the slap-up wedding hosted last week by their prime minister, Jose Maria Aznar, but the event certainly set tongues wagging. More than 1,000 guests gathered at Philip II's majestic El Escorial monastery for a nuptial mass conducted by Spain's cardinal-primate.

“A wedding fit for a princess?”, mused a Barcelona paper. Well no, not quite. But it certainly wasn't a private family affair either. Spain's king and queen were there, along with the British, Italian and Portuguese prime ministers. So too were a galaxy of jet-setters who grace the pages of Spain's so-called “press of the heart” but would rarely be invited to attend a truly state occasion. The entire government was there too, but no one from the opposition.

It was all rather out of character for a man whose own austerity is legendary. Mr Aznar paid around *euro*200 ($195) a head for a post-nuptial dinner and dance at a country estate that was loaned free of charge, and for a joint stag-and-hen party a couple of days earlier at a fashionable Madrid discotheque for 800 people. The Spanish taxpayer picked up a tab for security that cost, it is said, *euro*120,000.

Look to the wife, say some. Look to the new son-in-law, insist others. Alejandro Agag is a longstanding prime-ministerial aide turned banker, a decade older than his 20-year-old bride. Smooth and ambitious, he cultivated the rich and powerful while working on Mr Aznar's behalf in Brussels. Some of the more notable guests, such as Rupert Murdoch, a media mogul, and Silvio Berlusconi, a tycoon who now runs Italy, are Mr Agag's own pals.

In any event, some people in Mr Aznar's People's Party are twitchy. Ordinary Spaniards may think their prime minister had gone over the top. Not so, says Mr Aznar. Apparently determined to leave office in 18 months' time, he has brushed off the charge that the wedding was an end-of-era misjudgment. All the same, says a critic within the ruling party, “the Aznars wouldn't have dared organise an event like that when we were first elected.”

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Charlemagne

Why Brussels isn't boring

Sep 12th 2002
From The Economist print edition

After all, an entirely new system of running a continent may be afoot

ANNOUNCE that you work as a journalist in Brussels and you are likely to get a pitying look and a polite inquiry. “Do you find that interesting?” The implication is that only fans of watching paint dry could possibly answer “yes”. Right now the contrast between the dramas elsewhere in the world and the humdrum day-to-day business of Brussels is particularly stark.

As the world commemorated September 11th and President George Bush prepared to address the United Nations, the European Commission went about its normal tasks. It announced that it is looking at ways of harmonising car taxation; it trumpeted the fact that 80,000 pages of European Union law are about to be translated into nine new languages; and it signed a memorandum of understanding on “intermodal Pan-European corridor VIII”—ie, some roads and railways linking Albania, Bulgaria and Italy. Even the EU's occasional scandals tend to have a peculiarly dull stamp. The Americans had Monica Lewinsky. By contrast, the biggest scandal to hit Brussels this year is an accusation by the European Commission's chief accountant that the organisation has failed to use double-entry book-keeping.

But while the day-to-day details of EU affairs can be grim, the big picture is fascinating. Really. The Union has recently embarked on projects so ambitious that they challenge fundamental assumptions about both politics and economics. The euro is the first-ever attempt to create a real international currency (though Charlemagne himself had similar ideas). Until the new coinage began to jingle in pockets in 12 EU countries in January, it had always been the case, bar a few trivial exceptions, that a currency was issued by a country and backed by a national government and a central bank. With the euro, all that has changed. Will it lead to an economic government in Europe with a much bigger budget and tax-raising powers or will it establish a new way of managing currencies and monetary policy? This is not just a debate to engross economists. It will have weighty consequences for 300m-plus people who now use the new currency—and may inspire similar experiments elsewhere.

Not content with reinventing monetary economics, the EU is also remodelling the basic building block of global politics, the nation-state. It was Europe that invented the model in the first place, and Europe that now seems to be disinventing it. By joining the EU, European countries accept the supremacy of European law over national statutes. The EU tells the French when they may shoot small birds, the British how many hours they can work in a week, the Germans when they can subsidise their businesses. Delegates to a European convention are now pondering demands for a federal constitution for the EU.

Some believe that the Union is in effect turning into a new country—a United States of Europe—that will one day exercise power much as a traditional nation-state does. Others argue that the EU is doing something both less dramatic and more innovative. It is busy acquiring many of the characteristics of a nation-state, while actually creating something newer and more complicated. Either way, the consequences for the rest of the world will be drastic. A United States of Europe, if it ever came about, would profoundly shift the global balance of power. But a new hybrid political form, dependent on international law and deep co-operation between the older states, would create a political model which would challenge traditional assumptions about government all over the world.

So if the EU is so interesting, why does it seem so dull? Partly because most of the Union's formal day-to-day powers are technocratic: a merger to be approved or turned down; a trade dispute to be resolved; an environmental directive to be issued. But there is more of a connection between the drab details and the big picture than is often realised. Eurosceptics often argue that the integrationists promote their ambitions by stealth—by dressing up big political changes as mere technical adjustments. This argument can mislead. Sometimes it even smacks of paranoia. Sometimes, however, it is true. In a frank moment, Jean-Claude Juncker, Luxembourg's prime minister, once described the EU's “system”.

“We decide on something, leave it lying around and wait and see what happens,” he explained. “If no one kicks up a fuss, because most people don't understand what has been decided, we continue step by step until there is no turning back.”

Brilliant, but also slightly sinister

What Mr Juncker and those who think like him are trying to do is, in essence, to drown opposition to European federation in a mass of technical detail, to bore people into submission. As a strategy, it has gone a long way. The greatest single transfer of sovereignty from Europe's nations to the European Union took place, in 1985, as part of the project to create a single European market. Even Margaret Thatcher, not usually slow to spot a trick, later claimed that she had not fully appreciated the ramifications of what she was then signing up to.

But there are signs that this strategy of integration by stealth has run its course. EU politicians and civil servants are genuinely rattled by mounting evidence that their Union is seen as remote and overbearing. They hope that their new convention will help them to “reconnect” with ordinary Europeans. In the process, that will raise basic questions about national and personal identity. Do people yet “feel European”? Or are national identities still much stronger? How far can the EU stray into sensitive new areas like defence and internal security?

In dealing with such issues, the conventioneers will also have to start addressing the question of whether the EU is a state in the making or some new form of political organisation. And then there is another possibility, little discussed in Brussels. The whole enterprise may ultimately prove impossibly complicated and begin to creak and break apart as a result of its internal contradictions. Now that really would be interesting.

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Nuclear industry

Fallout

Sep 12th 2002
From The Economist print edition

What happens when government uses a privatised company for political ends

Get article background

BRITAIN'S electricity industry operates under a bracing regime. Energy shall be cheap, reliable, and from diverse, preferably renewable, sources. Generating companies must invest in new technology; neither their profits nor their losses are to be politically embarrassing. Investors interested in this thrilling prospect should please form an orderly queue.

This week's £410m ($635m) government rescue of British Energy, the country's privatised nuclear power generator, was the inevitable result of the government's ill-formed energy policy. Only three weeks after saying, in mid-August, that it was “not faced with an immediate credit crisis'', and despite £615m available for borrowing, managers asked the government for a bailout.

Alamy

Used nuclear industry, several careless owners

The immediate cause of the crunch was management failure. British Energy's share price plunged after a flurry of bad news about financial and technical hiccups. But even if British Energy's bosses were the best in the business, they would still have suffered from an energy market rigged against them. The government cares chiefly about cheap power, which is popular with voters and businesses. Privatisation and liberalisation in the 1990s made the industry more efficient, revealing a lot of spare capacity—around 25% of peak winter demand. Rejigging the market rules last year pushed down prices further. The current wholesale price is £16 per megawatt hour, about £3 too little for the company to make a profit.

That reflects the complicated legacy of privatisation and energy policy, which, in recent times, has encouraged the building of cheap gas-fired power stations, while leaving the nuclear industry with heavy extra costs. “This structure could only survive if the electricity price stayed up. But the oil price has trebled; the gas price almost doubled, and the price of electricity has virtually halved,'' notes Dieter Helm, an Oxford-based energy consultant.

What other countries do

Nuclear energy, 2001

Country	% nuclear	Electricity liberalisation	Waste
France	77	Slow and reluctant	Reprocesses
Japan	34	Just starting	Sends to Britain
Germany	31	EU laggard	Stores
Britain	23	Ahead of most EU	Reprocesses
United States	20	Yes, botched in California	Stores

Sources: www.world-nuclear.org; *The Economist*

British Energy's burdens are indeed heavy. Whereas competitors that burn gas, oil and coal get off the environmental hook lightly, the nuclear industry must pay £200m annually for its waste to be reprocessed, expensively, at Sellafield, the state-owned nuclear dustbin. That avoids finding a long-term dump to store it in, which would be unpopular, and keeps Sellafield's owner, British Nuclear Fuels Limited (BNFL), afloat. Storing the old fuel, which is what nuclear power industries in most other countries do (see table), would be a great deal cheaper. One of the triggers for the collapse was the failure of British Energy's increasingly desperate attempts to negotiate a much cheaper deal on waste with BNFL.

A second oddity is that British Energy has to pay the government's special tax aimed at reducing CO_2 emissions, even though it emits no carbon. The government justifies this curious imposition by arguing that the tax is designed to encourage renewable energy rather than to penalise the carbon-producers. It costs British Energy £80m annually. There are other handicaps too. Nuclear power stations pay higher rates (local taxes) than their conventional counterparts. And they also have to provide for huge future decommissioning costs.

The government's short-term loan has now given managers and politicians a couple of weeks to try to sort out the mess. The bravest thing to do would be to let the company go bankrupt. Shareholders and bondholders would suffer, and the assets would go to whoever was willing to pay for them. But that course sounds risky to politicians. Although there is little real likelihood of even a flicker in the electricity supply in the next few years, alarmist headlines—and public worry—would be unwelcome, even if ungrounded.

Arguments are raging about both principles and practicalities. The government, which has promised to publish a new energy policy later this year, is divided. A pro-nuclear lobby, mainly in the energy ministry, wants to prop up or even expand the industry—arguing, for example, that it is the most practical way of cutting greenhouse-gas emissions. The antis think Britain's whole nuclear adventure has been an expensive mistake and that the industry should be run down as quickly and smoothly as possible.

If British Energy is to be kept afloat, the government will have to lighten the political burden on the company. It will probably get a better deal on waste and taxes, and plans to release it from its historic liabilities, such as the cost of decommissioning old and clunky nuclear power stations, will probably be speeded up. The government may also give it a management contract—worth perhaps £20m a year—to run Britain's elderly Magnox nuclear power stations, which currently belong to BNFL.

For its part British Energy is hurriedly selling off its overseas assets, in America and Canada, where it is short of the cash needed to satisfy regulators. After that its top managers should start booking lunches with headhunters: the government is peeved by the nasty surprise, and particularly by the company's decision to pay its shareholders a hefty dividend in May, only months before it came begging for taxpayers' money.

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Politics

The price of war

Sep 12th 2002
From The Economist print edition

While Mr Blair worries about Iraq, the unions worry about him

Reuters

Fighting talk

Get article background

THE prime minister, Tony Blair, says he is willing to pay a “blood price” to prevent Saddam Hussein building up biological and nuclear weapons. But there could be a political price too. Speaking to the Trades Union Congress (TUC) this week, Mr Blair challenged the growing number of vocally anti-war union leaders to forgo rhetoric and work with the government to achieve common goals. “Indulgence or influence—it's a very simple choice,” he said.

The prime minister's unqualified backing of American military action against Iraq, however, means awkward choices. Dealing with Saddam and finding extra money for the military is bound to affect domestic politics—starting with a recall of Parliament for a one-day debate in the week of September 23rd, which the government announced this week.

The chief war casualty on the home front could be next year's referendum on the euro. An early date, Mr Blair's initial preference, is expected to slip in the event of war. The longer the delay, and the worse the economic outlook in France and Germany, the stronger will become the arguments for postponing the whole thing. While opinion polls show large majorities against both adopting the euro and attacking Iraq, Mr Blair will not want to risk both an unpopular war and an unpopular referendum.

Another possible victim—strongly denied by his allies—is Mr Blair's determination to reform public services. The broad base of union support that sustained Labour's first term of office has eroded. Old friends such as John Monks, the TUC leader, and Sir Ken Jackson, former head of Amicus, the manufacturing union, are leaving the stage. A new breed of noisy left-wing union chiefs has taken power such as Bob Crow (railways) Derek Simpson (manufacturing), Dave Prentis (public sector) and Mick Rix (train drivers).

An immediate test of the government's resolve is the threatened national strike by Britain's firefighters, who are demanding a 40% wage increase taking their basic pay to £30,000. The last fire service strike, 25 years ago, went on for nine weeks. The government cannot afford to be seen to cave in but the pay campaign has public support. Both train and tube drivers have promised to help by stopping services. Laws against secondary strikes normally prevent this sort of thing, but the drivers say it would be unsafe to run trains with no firemen available.

All this may be awkward for the government but threats of a return to 1970s-style industrial mayhem are

overdone. In truth, the TUC is deeply divided and the union movement has never been weaker. It represents less than 20% of private sector workers; even in the public sector, it has only 59%. For all the militants' hot air, most trade union leaders know that their power is strictly limited and that they have little to gain by sniping from the sidelines. Bob Crow, the fiery leader of the RMT, failed even to be elected to the TUC's governing body this week, the first rail leader not to win election to the general council.

The government will not budge on the unions' more extreme demands for repeal of all the Conservatives' trade union legislation. The employment relations minister, Alan Johnson, a former trade union general secretary, has said there is not “an ice cream's chance in hell” that the government would remove the requirement for ballots before strikes, or allow the return of the closed shop. But Mr Blair cannot ignore union concerns over public-private partnerships, pensions, and employment laws. With the party haemorrhaging members and woefully short of cash, he needs their support more than ever.

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Defence companies

The war dividend

Sep 12th 2002
From The Economist print edition

Standing shoulder to shoulder with America is good for business

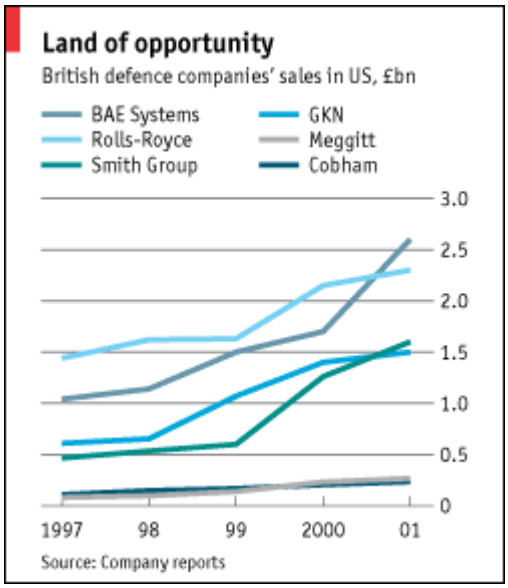
BRITAIN has a large and thriving defence industry, ranking second only to America in the world market. Companies such as BAE Systems (formerly British Aerospace), Rolls-Royce and Smith Group are leading suppliers of defence equipment—mostly related to aerospace, which is by far the biggest part of the defence equipment market.

But this success story may not last much longer. Not that defence is about to decline like coal mines, steel and textiles, whose customers turned to cheaper suppliers in poor countries. Quite the opposite: Britain's defence industry is shifting its centre of gravity to America, where its sales and investments are growing fast. “It's not a trend, it's a bloody stampede,” says one industry economist. Sales of defence equipment in America by the top six British defence aerospace companies have doubled since 1997. BAE sells more these days to the Pentagon than it does to Britain's Ministry of Defence.

But this is no rousing story of export success: the sales are largely of equipment made in America by subsidiaries of British firms. “America insists on local production to offset 100% the value of a contract,” says Keith Hayward, chief economist at the Society of British Aerospace Companies (SBAC). So even if some widgets are made in the British Midlands or technology is cooked up in Farnborough and sold across the Atlantic, the company will have to make goods of equivalent value in the United States. Most of the manufacturing has to be done in factories that the British companies build or acquire over there.

There are clear reasons for this westward migration. First, America is, unsurprisingly, by far the biggest defence market in the world, buying about half of the $200 billion of military hardware produced in the world each year. And last year's terror attacks have helped trigger a rise in spending on defence equipment, which is tripling from the post-cold war trough it hit in the mid-1990s.

Second, British companies are well received in America because they are seen as trustworthy cousins. The Pentagon worries about sharing technology with the French or Germans for fear it may find its way into the hands of unsavoury regimes. The British tend to comply more easily with American restrictions on export of defence technology. And Britain's readiness to stand by America goes down very well in the Pentagon. Try as they might, continental European defence companies such as Thales and European Aeronautics Defence and Space (EADS) have a harder time getting into the Pentagon. Thales even bought a smallish British company, Racal, partly to use as its ticket to America.



BAE has become very big in America after a string of acquisitions in recent years, taking over parts of American defence contractors that were up for grabs as the local industry reorganised. It also finds it easier than continental Europeans to win Pentagon approval for such deals. Some industry observers even suspect that BAE will one day re-locate its headquarters in America. Its chairman, Sir Richard Evans, explains his expansion in America by pointing out that he has to direct his efforts to the best market.

Defence budgets in Europe are tiny and barely growing. Pan-European projects such as the Eurofighter aircraft take for ever to enter production: the Eurofighter itself is ten years late, and a proposed military transport plane, known as the A400M, has just been delayed again by the Germans despite being

discussed for over 15 years. Military campaigns such as Kosovo and Afghanistan have highlighted the need for more modern transporters.

Outside those cumbersome joint defence programmes, Britain finds it hard to break into the markets of its fellow Europeans. Germany buys little, while France buys only French. Other Europeans with no big home industry tend to buy American because they are cheaper. Britain may be entertaining a bid from a French company, Thales, to build the new aircraft carriers it needs, but it would be pointless BAE trying to do the reverse.

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Exporting invisibles

PFInancial services

Sep 12th 2002
From The Economist print edition

British firms are flogging PFI around the world, and the world is buying

STEPHEN HARRIS is a busy man. He works for International Financial Services, London—formerly known as British Invisibles—which promotes the export of City expertise. Last week he was in Switzerland, this week he's hosting the Estonians, next week it's the Mauritians and the Danes. In fact, Mr Harris is talking to over 30 foreign governments. What is he talking about? The private finance initiative (PFI), which he hopes will be Britain's most eye-catching “invisible” export since privatisation.

“Privatisation”, said one of its early champions, “is an ugly word for a beautiful concept.” Governments could get shot of underperforming industries, pocket the proceeds and spread popular share-ownership at the same time. Having sold a bunch of Britain's state-owned assets to the public, the City's bankers, lawyers, accountants and consultants went on to sell the idea around the world, as far afield as Brazil and China.

The “private finance initiative” is an ungainly term for a more subtle concept. Rather than selling off assets the government already owns, the PFI raises private finance for infrastructure projects—bridges, hospitals, or prisons—that don't yet exist. According to Tim Stone of KPMG, an accountancy firm, Britain is “ten years ahead of everyone else” in the delicate art of matching private money to public needs. Almost 500 PFI projects have been signed in Britain; nowhere else yet comes close.

But the PFI is not universally loved in its country of origin. The British press and public either ignore it or lampoon it. The unions hate it. In the same week that Mr Harris meets the Estonians, UNISON, Britain's biggest public sector union, is holding a conference accusing the PFI of “Failing Our Future”. What do the Estonians see in PFI that UNISON doesn't?

Mr Stone thinks foreign governments are keen to learn from mistakes, as well as successes, in Britain. In particular, the British experience starkly illustrates the importance of getting the contract right. If the contract does not spell out who takes on the risks of a project, they'll usually end up in the government's lap. If the contract does not penalise bad service, then bad service is probably what you'll get. On the other hand, if written well, a PFI contract can align the interests of the financiers backing the project with the interests of the public using the project. If poor service brings poor financial returns, it will be rooted out by ruthless financiers, not tolerated by sleepy bureaucrats.

Some of Britain's overseas clients have been quite innovative in spelling out what counts as good service. In South Africa, for example, the plan for the Gautrain rail link between Johannesburg and Pretoria includes clauses on black empowerment and local investment. Speaking from Uganda, Charles Morrison of the City law firm Denton Wilde Sapte argues that these new styles of procurement give poorer African governments, in Uganda, Ghana or Tanzania, the chance to decide for themselves what their needs are and how they should be met, rather than having their donors decide for them.

For some overseas governments, PFI may have another, less noble, appeal. Mr Harris admits that some of his guests roll up thinking PFI is a way to get “free infrastructure”. It's certainly not that. As he and Mr Stone emphasise, the government pays for the services the infrastructure provides, and these payments, extending over 20 or 30 years, must be generous enough to attract private finance in the first place. Since private finance is usually more expensive than public finance, PFI's critics see it as a costly way for governments to shift borrowing off their books. If overseas governments do see PFI as a neat accounting trick, it will no doubt be a hit export, improving Britain's invisible overseas trade. Whether it will visibly improve overseas infrastructure is another matter.

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London buses

Bends v curves

Sep 12th 2002
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Why mourn creaky old buses when you can welcome new ones

TO LISTEN to the protests, one would think that EuroDisney was taking over the Tower of London. Admittedly, London's dwindling fleet of old-fashioned double-decker red Routemaster buses, like the black taxis and old red telephone boxes, are a distinctive and attractive feature of the city's landscape. It is also true that London's new single-decker bendy buses, which are widely used on the continent (they hinge in the middle and therefore go round corners easily) are foreign, and therefore—to traditionalist tastes—unwholesome and unwelcome.

But reality is more complicated. Passengers will be able to leap on and off the city's 500-odd old-fashioned buses at least until a European directive on accessibility comes into force in (gasp) 2016. London's transport authority says it will consider asking for an exemption even then. By most rational lights, the bendy buses, of which 31 are already in service with another 70 coming by next year, are a welcome innovation. They have a lower floor, making them easier to board. They carry more people than ordinary single-decker buses. They have flat fares, and are cashless. Passengers must buy their tickets in advance, or from a machine, rather than from the driver as in most London buses. These strange ideas work well elsewhere.

But efficiency arguments do not appease the nostalgics. Not only are the Routemaster's curvy lines more beautiful, they argue, but their layout requires a conductor to sell tickets—a social benefit, they claim. Steve Pound, himself once a bus conductor and now a Labour MP, says that this allowed, for example, parents to send their children to school unaccompanied. “Anything that looks overstaffed can be stripped down by some pinstriped, cocaine-snorting consultant,'' he complains. “When I worked on the buses, there was a pride, an ethos.''

Most bus passengers probably prefer the main features of their bus travel to be cost, safety and reliability, though, which probably means efficiently run new buses, not expensive old ones. Those really wanting the authentic experience can always take the much pricier private tourist buses through London. These invariably use Routemasters, but with the extra benefit of exposure to real British weather on their open-topped upper decks.

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Employment laws

Time is money

Sep 12th 2002
From The Economist print edition

New regulations from Brussels weigh heavily on British business

TONY BLAIR may have had a surprisingly easy time at this week's TUC conference in Blackpool, but there was at least one good row. Bob Crow, general secretary of the RMT transport union, called for a total repeal of the Conservative laws that curbed the powers of the trade unions. Rejecting this call, Alan Johnson, the employment relations minister, dismissed the revival of finger-jabbing rhetoric by some trade union leaders.

But this was mere shadow-boxing. Whatever their public posturing, union leaders and ministers know that Britain's workplace is now shaped far more in Brussels than in London. A tide of European laws is succeeding, where trade unions failed, in conferring more rights on employees. These gains come at a cost not just to employers but also to taxpayers as the economy generates less output.

Since the end of 1999, for example, parents have enjoyed new rights to take time off when they have a young child. Fathers have been able to insist on this for the first time and mothers also get extra time with their young children over and above maternity leave. Both become eligible to this right to parental leave after working with their employer for no more than a year.

European directives are also granting workers new rights to be informed and consulted on what their employers are planning especially with regard to employment. Since the start of 2000, large multinationals have had to comply in Britain with a law establishing European works councils. Under a new directive—originally opposed by the Labour government—any firm with 150 or more staff will from 2005 also have to inform and consult its workers about its business and employment prospects. When this right is extended in 2008 to firms with 50 or more staff it will cover 75% of all employees.

Trade unions hope—and employers fear—that this will become a platform for the unions to claw back recognition in private-sector workplaces, where less than a fifth of employees are members. “The unions have good reason to see this as a very good way to increase their influence in the workplace,” says Ruth Lea, head of the policy unit at the Institute of Directors.

Other European-inspired legislation has given part-time and fixed-term contract workers the right to be treated as favourably as comparable full-time employees. The EU is also planning to confer new rights on agency staff, so that they enjoy the same rights at work, including pay, as comparable employees in the companies where they are temping after six weeks.

All this new legislation has been passed under the social chapter of the Maastricht treaty, which has applied to Britain since 1997 when Tony Blair relinquished the opt-out John Major secured in 1991. But the most onerous law of all has been the working-time directive, passed as early as 1993 as a health and safety measure to create a level playing field in the single European market. After a prolonged and unsuccessful legal challenge by the Conservative government, the directive finally became law under Labour in October 1998. Its most important provision restricts the average working week for most employees to a 48-hour maximum.

The impact on employers and the economy has been substantial. According to the British Chambers of Commerce, the directive is costing employers £2.3 billion a year. Although there are a number of exemptions, it has had a clear effect on the average number of hours worked per employee (see chart).

This has dropped by nearly 3% since spring 1998 even though the economy has grown respectably over most of this period.

The Treasury argues that the effect of the directive in reducing hours has now largely run its course. But this seems unlikely. For one thing, the directive will be extended over the next two years to cover transport workers and junior doctors, currently excluded from its provisions. For another, individuals can at present opt out of the 48-hour limit on the working week. But in a year's time the European council of ministers will review this provision in the legislation. Since it has only been used in Britain, retaining the individual opt-out is likely to prove difficult.

With 4m employees continuing to work more than 48 hours a week, there is plenty of scope for the directive to cut time at work still further. This will reduce future economic growth. In the April budget the Treasury raised its long-term growth forecast from 2.5% to 2.75% a year. This is already beginning to look over-optimistic. If average hours worked continue to decline at the current rate, the projected increase could be wiped out. Employment rights sound fine but they are costly not just to employers but to the wider economy.

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Fat children

Regime change required

Sep 12th 2002
From The Economist print edition

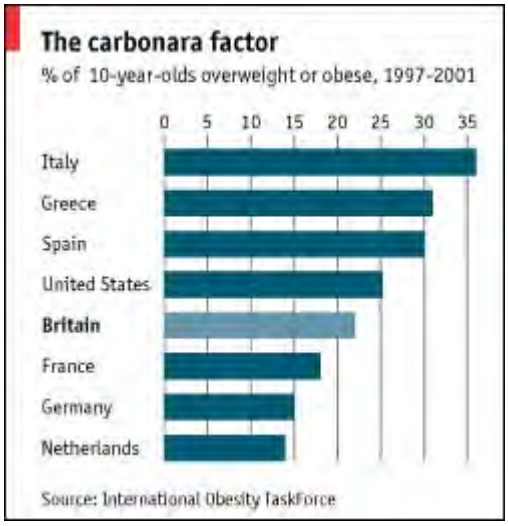
Well past pear-shaped

SPHERICAL carrots—perfectly round, about the size of a golf ball—are the latest lunchbox-friendly gimmick to hit Britain's supermarket shelves. Spherical children—distressingly round, and big enough to put their own lives at risk—are the latest walking health-hazards to hit the nation's streets.

Andrew Prentice, a professor of nutrition at the London School of Hygiene and Tropical Medicine, suggested this week that obesity is now so widespread (hem) that it represents an evolutionary shift in human body-shape. People, says Mr Prentice, are undergoing a change similar to that which occurred 200 years ago, when Europeans went through a 30cm growth spurt—only this time they are expanding not upwards but outwards. And whereas getting taller is a symptom of healthier living, this new trend is a harbinger of chronic illness and untimely death.

Obesity costs the NHS some £500m a year, and the economy £2 billion through sickness and early deaths. Since the early 1980s, the rate of adult obesity in Britain has trebled. Among children, it has doubled. The rate is now increasing almost as quickly as it is in America, although the prevalence of obesity in Britain still lags behind the land of the free and the home of the burger. Today, more than one-fifth of British kids are overweight or obese. Mr Prentice says that it is possible that sedentary, poorly nourished youths will die before their parents. Earlier this year, three girls and a boy, all severely overweight and aged between 13 and 15, became the first recorded cases of white children in Britain to be diagnosed with type-two diabetes, a condition usually only seen in adults over 40.

The rising rate of obesity in Britain reflects a worldwide trend, and one which is no longer limited to rich countries. But Britons can take some consolation in the fact that they are not quite so fat as many of their continental counterparts (see chart). Just look what a diet of pasta, provolone and tiramisu can do for your waistline—*mamma mia!*



The spherical carrot does not in itself represent a solution to child obesity, of course. But carrots, along with other vegetables and fruits, are an essential part of it. If spherical carrots are what it takes to encourage recalcitrant youngsters to eat fresh vegetables, well, so be it. Better the carrotball than the butterball. And far from being a scary 21st-century Frankenfoodstuff, the spherical carrot was developed in France around the time Napoleon was settling in as First Consul—back when everybody was short and kids were just chubby.

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Gaelic

(Never) mind your language

Sep 12th 2002 | PORTREE, ISLE OF SKYE
From The Economist print edition

Reviving Gaelic is a tall order, even with taxpayers' cash

DESPITE Scotland's robust nationalism, there are few takers when it comes to Gaelic, an obscure Celtic language spoken by a dwindling 60,000 people (just over 1% of the population). That contrasts with Wales, where political sentiments are milder, but the proportion speaking Welsh is 19% and rising, largely thanks to generous official encouragement in recent decades.

Supporters of Scotland's ancient tongue such as Calum MacDonald, MP for the Western Isles, one of the few places where it is much spoken, blame bureaucratic hostility. He recalls suggesting some bilingual road signs when he was a Scottish Office minister in 1997-99. Officials objected, he says, maintaining that the signs would be too large and obscure the Highland scenery. When he then wrote a letter overruling them, they forgot to post it.

Gaelic campaigners are asking for more Gaelic-medium education (where all subjects are taught in the language). Set up in 1985, such schools now attract 1,900 pupils a year. Another demand is a taxpayer subsidy for Gaelic digital television. That would expand output to 12 hours a day from the current level, on average less than half an hour.

This would push up the cost of supporting Gaelic from about £14m to more than £20m a year, about a quarter of the money spent on keeping Welsh alive. “Gaelic has been a part of the identity of Scotland and indeed Britain, and securing it secures access to our heritage,” says Donald Meek, professor of Gaelic at Edinburgh University. “When a language dies, a window closes and the world is a darker place.”

Poetic stuff. But the first people to convince are those who actually speak the language. Although outsiders are sometimes enthusiastic about their children learning Gaelic, language campaigners admit that many locals have long thought that it is English that matters most for their bairns' future. Professor Meek grew up on the Gaelic-speaking island of Tiree, but says his parents thought it was “not worth the bother” for him to learn the language.

Welsh suffered from the same inferiority complex but managed to overcome it. On current form, though, Scotland looks more like Ireland, where governments in the last century spent huge sums vainly trying to revive Irish—the third living Celtic language in the British Isles. Scottish taxpayers would be right to flinch at forking out much more.

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After the chaos

Sep 12th 2002
From The Economist print edition

To prepare for accession to the European Union, Central European countries need to speed up reform of their financial sectors. But old habits die hard, writes David Shirreff

"NEVER ask a man where he made his first million," advises a stockbroker in Prague. Ten years of chaos in Central Europe (here defined as the Czech Republic, Hungary, Poland, Slovakia and Slovenia) and points east, as a dozen countries ripped up communism in favour of market economics, allowed many opportunists to get rich quick. Some did so honestly; many more cheated, bribed and stole from the state or small investors, using conniving banks as a source of everlasting loans and a place to wash their money.

That era is coming to an end, at least in the more advanced countries. Emerging from the chaos are new structures that are beginning to resemble the financial systems in Western Europe, complete with banks (mostly foreign-owned), stockmarkets, mortgages and pension funds, bank supervisors, securities commissions, property laws and governance codes.

In this brave new world, why question too closely how some people, many of them now ministers, top managers and pillars of society, made their early fortune? It makes sense only if they are still up to their old tricks. When corruption persists at the top, it percolates throughout the economy: people do not trust their leaders; they hide their money; they expect to pay and receive bribes; and banks do not trust their customers. To some extent that culture lingers on, even in Poland, Hungary and the Czech Republic, soon to become members of the European Union.

But nowadays the prospect of EU accession is prompting even corrupt leaders to pay more attention to reform. Ten countries selected for the first wave are racing to complete the requirements laid out in 31 “chapters”, which include institutional reform, new laws, new tax regimes and anti-corruption measures. Hopes of accession, and fears of being bumped off the list, are concentrating minds.

Some former ministers and company bosses who lined their pockets in Poland and Serbia are now in jail. Many more of those formerly on the take are walking free. But for now everyone is inclined to draw a line and concentrate instead on moving towards better, cleaner, fairer and more efficient financial systems. The rewards include cheaper capital to fuel the economy and more saving by trusting consumers. Some reformers, such as Leszek Balcerowicz, the governor of Poland's central bank, think that financial reform can improve even such things as health care and income distribution.

At the heart of these reforms are the banks. They account for about 80% of financial assets in these countries, in most of which securities markets are still widely underdeveloped. Communist bankers did not have to worry about credit risk because neither they nor their borrowers could go bust. After 1990, as market forces kicked in, almost every country in Central Europe had a banking crisis, but each dealt with its insolvent banks in different ways. The Czech Republic, for example, turned a blind eye for years, believing that banks were magical engines of growth. Not until the late 1990s did the Czech government privatise its big banks at huge expense—equivalent to 21% of one year's GDP.

Hungarian reformers were much quicker to cotton on that the banks needed new owners, new capital and new management. They began to privatise them in 1994, judging that the price was less important than getting them into responsible private (which meant mainly foreign) hands. Serbia started reforms only two years ago, emerging from years of war and cronyism under President Slobodan Milosevic. Learning from the experience of others, it closed several of its biggest banks earlier this year, cutting off ailing industries from addictive soft loans. Such prompt action may save Serbia most of the huge expense—equivalent to between 10% and 25% of annual GDP—that delay has cost other Central European

countries, but it put 9,000 banking staff out of work overnight. The dusty windows of disused bank branches stare down all over Belgrade.

Foreign umbrella

The other leg of banking-sector reform is foreign ownership. Only a handful of banks in Central Europe have shown that they can compete without the backing of a foreign bank, its risk-management systems, its range of products and its credibility. One of them is OTP, the biggest bank in Hungary. Once a savings bank with a monopoly of the retail market, it has thrived because of good local management. Another, although not so well run, is Bank PKO BP in Poland, which also had a monopoly. Almost all other successful banks in the region are owned by foreign banks. Even Slovenia, which for years resisted big foreign investors for fear of being swamped by foreign capital, sold two biggish banks to foreigners last year, and is negotiating the part-sale of its biggest to a Belgian bank. Neighbouring Croatia has been the most outward-looking: 90% of its banking assets are foreign-owned.

In theory, this foreign ownership plugs the financial sector into the western world, bringing higher standards of governance and better access to capital. More competition means lower lending premiums, especially for small and medium-sized businesses. Foreign ownership also offers a fast track to new financial services such as mortgages and leasing. All of this increases the deployment of funds where they are needed, and coaxes savings from under mattresses and out of offshore accounts. The parent banks usually make a better job than local supervisors of overseeing their new subsidiaries. Often there is an implicit safety net: the parent will not let its offspring go bust, thus providing a lender of last resort for part of the financial system.

But banks cannot do it all. The big disappointment in Central Europe has been the slow development of alternatives: capital markets and private equity. Most of the countries built stock exchanges with great fanfare. Thanks to mass privatisations, some of them had thousands of companies listed. But new capital failed to arrive, or if money came in from abroad, it soon flowed out again as the fad for emerging markets lost favour. Worse, company shares, traded without enough disclosure and without enough volume to establish convincing prices, invited all kinds of market abuse and flouting of minority shareholders' rights. Only now are some of these problems being tackled in the few markets that are not dying a slow death.

On a larger scale, each local capital market is facing a choice: should it fight for its national identity, or append itself to a pan-European exchange? This is not just a question of patriotism. These countries are belatedly trying to build up funded pensions for their citizens. Arguably, a good chunk of those funds should benefit the local economy, rather than be invested in government bonds. Pension and insurance funds are vital to capital markets. They helped Chile build a robust market, and are beginning to do the same in Poland.

It took time to recognise that countries emerging from communism desperately need small and medium-sized businesses. Some of them, especially former Yugoslavia (the rump of which, confusingly, is due to change its name to Serbia and Montenegro next year) had an artisan tradition, but in others private initiative was heavily discouraged. In Romania, to kill a pig for Christmas you needed permission from the mayor. The American government started the Polish-American Enterprise Fund in 1990 to foster small business, but the initiative spread only slowly to other countries.

The European Bank for Reconstruction and Development (EBRD) changed tack in 1994 and began lending to banks to encourage small businesses. This approach has been most successful in Russia, and in such unlikely places as Albania, Bosnia & Hercegovina, and Kosovo. The model is Germany's famous *Mittelstand*, the small and medium-sized companies that have proved such a trusty engine of economic growth there. But building up small companies takes time, enlightened loan officers and enforceable procedures for collecting loans and seizing collateral.

The countries of Central Europe do not have time. They are in a race to qualify for the greater Europe. Their legal systems and institutions are being wrenched into compliance with EU law, but their judges, lawyers and administrators find it hard to change their habits of 50 years.

All the same, after ten years of going up blind alleys, most countries in Central Europe appear to be moving forward. They can now choose from a menu of past experiments in banking and financial-sector reform, depending on what stage they have reached. But there are worries that they might go off the rails again. The banks are not lending enough, corruption is not dead, and bloodshed nearby is still a

recent memory. Accession to the EU for all or some of the chosen ten still needs to be ratified at the EU's December summit in Copenhagen. Just imagine the financial shock to Poland, says one analyst, if its accession were knocked off course. Plenty went wrong in the past decade. Plenty more could go awry.

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Grab and smash

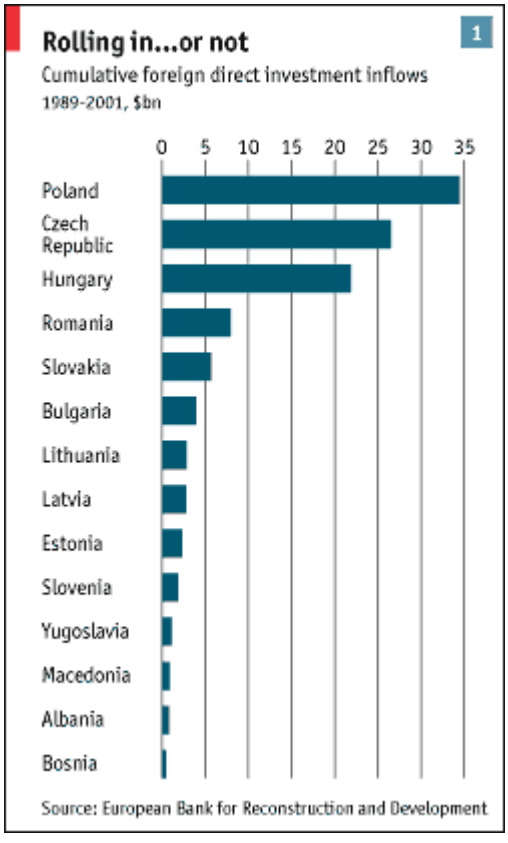
Sep 12th 2002
From The Economist print edition

In the scramble for state assets, financial discipline was forgotten. Many countries are still paying for the resulting crises

IT SEEMS only yesterday that all of Central Europe was a giant construction site. In the haste to rebuild the economy, banks became the puppets of politicians and the new class of bosses; old factories were carved up by their former managers and machinery disappeared. Multilateral agencies such as the World Bank, the IMF and the EBRD tried their best to help at the birth of these new nations, but their money, too, often went astray.

Most countries made the mistake of attempting to do everything at once. The extreme case was former Czechoslovakia, with its "big bang" privatisation in 1992. Citizens were entitled to buy vouchers which they could exchange for shares in a bewildering choice of companies. Many put their trust in poorly regulated investment funds to make the choice for them. It was a wild era in which a few sharp individuals made fortunes, gathering enough shares to control companies. Many of the assets in which the funds invested also ended up in the control of the fund managers, some of them supposedly respectable western banks. This big-bang world did not bother with too many rules. Poland, Romania, Slovakia, Croatia and, famously, Russia chose voucher privatisations, with more or less similar results. The best that can be said is that these companies were taken off the state's balance sheet, and that investors lost an opportunity but not much money.

Hungary took a different road, preferring to sell companies to those with real money—that is, foreigners. Hungary's target was to attract $10 billion of foreign direct investment in the first decade. It had already reached that level by 1995, even as other countries dithered over selling the family silver. Only towards the end of the decade did Poland and the Czech Republic catch up and attract more (see chart 1).



Voucher privatisations have since been condemned as a mistake, but the Czech Republic's second wave of privatisation was probably worse. It involved auctions, voucher privatisations or direct sales, often to the companies' own managers. The Czechs' aversion to foreign investment left their entire economy undercapitalised, with dire consequences for companies and their creditor banks.

Much the same happened in neighbouring Slovakia. Ivan Miklos, now deputy prime minister for the economy, recalls his experience on the supervisory board of Slovakia's National Property Fund, from which he resigned after a year: "In that year the fund sold 900 companies, but only one to a foreign buyer. It was impossible [for me] to get information about the sales." National property funds in several other countries were open to this kind of abuse, and even western companies saw opportunities that tempted them to throw corporate governance and rights of minority shareholders to the winds. Some of the canniest wheeler-dealers carried on for years, running companies and banks, bribing politicians and deceiving shareholders; they were suspected of being crooked, yet still feted by a public used to the ways of a communist elite. Some ended up in jail, or vanished.

Perhaps surprisingly, the Czechs, the most disciplined and orthodox folk under communism, fell further from grace than others. Many now blame the extreme liberal ideas of their architect of reform, Vaclav Klaus, who was prime minister in 1992-98. He believed that freeing the market was more urgent than establishing an institutional framework. For a while western reform gurus, such as Jeffrey Sachs and Larry Summers, lent their support. But today most people believe that Mr Klaus's big bang created little economic growth, but a kleptocracy as bad as Russia's. Until last June the two main Czech parties had a so-called “opposition agreement” under which they refrained from digging into each other's recent history.

Except for some industrial dinosaurs, such as shipyards, metal plants and mines, most industry in Central Europe is now in private hands. That seems a useful outcome, even if ownership was not always properly transferred nor claimants' rights always respected. Noreen Doyle, vice-president of the EBRD, which has stepped around the dirty deals where it could, concludes: “You can't unscramble the past.”

The sooner the better

The sick organ that used to keep these kleptocracies alive was the banking system. In Hungary in 1995, the finance minister, Lajos Bokros, and the central bank governor, György Suranyi, saw “deep corruption and cronyism in the banks”, recalls Peter Mihalyi, who was then number two at the privatisation agency. Hungary is praised for having tackled its banks early, but it did so for largely pragmatic reasons. From 1992 to 1994 the government several times had to recapitalise the banks that it had spun out of the National Bank of Hungary. In the end it recognised the need for foreign capital. “The only reason we privatised the banks was because they were about to blow up,” says Mr Mihalyi.

In July 1994 Bayerische Landesbank and the EBRD bought 25% and 17% respectively of the Foreign Trade Bank (MKB). Two years later the EBRD and GE Capital bought Budapest Bank, ABN Amro bought Hungarian Credit Bank (MHB) and ING, another Dutch bank, bought Dunabank.

The National Bank of Hungary had got the ball rolling in 1989 by selling Tungsram, a light-bulb maker, to RZB, an Austrian bank. RZB quickly made a tidy profit by selling Tungsram to General Electric (GE). The Tungsram deal was “one of the most successful ever made in Hungary”, says Mr Suranyi, who is now head of multinational banking at IntesaBCI, an Italian banking group. It was a positive symbol of the whole privatisation process, he says. GE put in fresh capital and quadrupled the firm's light-bulb output in Hungary.

Jacek Siwicki, who was Poland's deputy minister of privatisation at the time, agrees there was a need to attract some big names, such as Pepsi, Goodyear and Henkel, rather than trying to sell shipyards and steel mills. The big names raised Poland's profile and showed investors we were “guys you could do business with”, says Mr Siwicki, who now runs Enterprise Investors, the biggest private equity fund in Central Europe. Despite the problems, he marvels at how far his country has come.

But Poland was more cautious than Hungary about selling control of its banks to foreign investors. Although it floated bank shares on the stockmarket and sold minority stakes from 1997, the first majority bank stake it sold was in 1999: 50.1% of Bank Pekao to UniCredito of Italy. The upshot was that in the mid-1990s Polish banks had little access to new capital and western risk-management and IT systems. On the other hand bank shares were traded actively, which benefited the local stockmarket.

Now around 70% of Poland's banking sector is in foreign hands and the banks are moving towards western standards of service. But this was hardly part of the big bang that Leszek Balcerowicz, Poland's arch-reformer, inflicted on the rest of the economy. Today Mr Balcerowicz, who had two stints as finance minister (1989-91 and 1997-2000) and is now governor of the central bank, talks about the importance of radical and sustained reform and the need to build reliable financial institutions. But Poland, like almost every other country in transition, dragged out its banking crisis: it chose to bail out its banks in 1994 rather than cutting their ties to troubled enterprises.

The Czechs paid most heavily of all for botching the clean-up and privatisation of their banks, until the job was eventually done properly. “If you screw up your banking sector, the whole economy suffers,” says Joanna James at Advent International, which invests private equity in Central Europe.

Unintended consequences

In 1997 the Czech government made a rather silly mistake that lost it control of a bank without putting it in safe hands. Investicni a Postovni Banka (IPB), the country's third-biggest, needed new capital. The government's National Property Fund, which owned 47% of the bank (and another 3% through an investment fund), inexplicably ducked the capital increase, so its stake was diluted. IPB, although a popular retail bank, had a bad reputation for buying political favours from both main parties. Technically it had now been privatised, but its balance sheet had not been cleaned up. When Nomura Securities, a Japanese investment bank, expressed interest in a minority share, it was hailed as the “western” strategic shareholder that would give IPB world status and credibility.

But when the bank needed more capital, Nomura saw no reason to oblige. It had already made a tidy profit by selling two breweries owned by the bank and its investment funds to a South African buyer. It wanted the government to step in and make the bank saleable to a foreign buyer. In June 2000 there was a run on IPB, on rumours that it was about to report more losses. The government intervened on a Friday, sending in special forces sporting balaclavas and sten guns. Without time to organise a proper auction, and fearing a systemic banking crisis, the government decided to hand over IPB on the following Monday to Ceskoslovenska Obchodni Banka (CSOB), the best-run local bank, which had been sold to KBC of Belgium the previous year. It was a controversial and costly move that allowed CSOB to acquire another bank virtually risk-free. It could cherry-pick assets from the IPB portfolio and consign the rest to the bank consolidation agency, in exchange for government bonds.

This was the second time the government had ended up paying top dollar to get a bank off its hands. The first had been early in 2000 when it agreed to the sale of the biggest savings bank, Ceska Sporitelna, to Erste Bank of Austria. Sporitelna's existing loan book was ring-fenced: Erste and the government could pick the loans they wanted, and the rest went to the consolidation agency. But the government eventually learned its lesson. When it sold the last big bank, Komercni Banka, to Société Générale last year, it insisted that the French bank buy the loan portfolio and the bank as a package deal.

Slovakia, which split away from the Czech Republic in 1993, did little to privatise its banks until 1998, when the xenophobic leadership of Vladimir Meciar came to an end. Six banks had collapsed in five years. The gross cost of restructuring the three biggest banks was the equivalent of 11% of GDP, according to Ivan Miklos, deputy prime minister for the economy. The net cost, after selling the banks and auctioning their bad loans, will be between 4% and 6% of GDP, he estimates. The buyers of the three banks were Erste of Austria (adding Slovenska Sporitelna to its sister savings bank in the Czech Republic), IntesaBCI of Italy and OTP of Hungary.

The war in the Balkans meant that only Slovenia, the smallest and least affected of the former Yugoslav republics, was able to establish strong links with western economies. It had a head start. Even under Yugoslav socialism, the Slovenes had close ties with western businesses. Many had worked in Germany as guest workers; many of the brightest from other parts of Yugoslavia had settled in Slovenia as economic refugees. But Slovenia's size and its hostility to foreign influence meant that for years it resisted foreign capital as a solution for its banks and cash-starved industries. When Austrian and Italian banks two years ago were eyeing up the country's second-biggest bank, Nova Kreditna Banka Maribor, “there was such a stink from its citizens that the project was put on hold,” says an American banker who was there at the time.

Slovenia's concern, beside a fear of re-colonisation by neighbours after only ten years as an independent country, was the stability of its currency in the face of large capital inflows or outflows. Grudgingly, under pressure from the European Union, the government allowed foreigners to buy minority stakes in banks. Société Générale bought a minority stake in SKB Bank and was later able to build a majority, which included taking over a 14.9% stake held by the EBRD. SanPaolo IMI, an Italian bank, bought a 62% stake (but with only 33% of the voting rights) in Banka Koper last year. The jewel is Nova Ljubljanska Banka (NLB), the country's biggest. “I would have bet my salary a year ago that this bank would never be privatised,” says Murat Yildiran, the EBRD's representative in Ljubljana. But in May, KBC of Belgium won agreement to take a 34% stake, with the option of buying more over five years, though the sale still needs approval from the National Bank of Slovenia.

Serbia, less than two years into its reforms, has shut 23 banks, including four of its five biggest in January this year. Did it jump or was it pushed? The World Bank and others had plenty of advice for it. A World Bank survey on financial transition, published in July 2001, pointed clearly to the high cost of delaying bank reform. But taking the plunge still needed courage. Mladjan Dinkic, the governor of the National Bank of Yugoslavia, used a form of controlled bankruptcy to close the banks, giving plenty of warning to foreign interbank depositors to withdraw their money.

Unloved assets

Serbian investors were not sorry to see these banks go because Slobodan Milosevic, the then president, had seized their foreign-currency deposits to finance his wars in Bosnia and Kosovo, replacing them with near-worthless government bonds. The cost of the bank closures in January was about $4 billion, the equivalent of 1% of GDP, modest compared with similar moves in other Central European countries. Now the banks are being prepared for sale towards the end of the year.

“We paid a high political price for closing the banks,” says Miroljub Labus, deputy prime minister in the Serbian government. “Now the banking sector is improving and savings are growing.” He fails to mention the bank they did not close, Komercialna Banka, which is popularly known as the “police” bank because of its closeness to the security forces: rumour has it that this bank was too sensitive even for Mr Dinkic to touch. But now it is a possible choice as a home-grown banking champion. “I would like to see two or three domestic banks competing with foreign banks, something like OTP in Hungary,” says Mr Dinkic. OTP, Hungary's biggest bank, floated its shares on the stock exchange rather than acquire a foreign strategic investor.

Croatia, a war zone until the Dayton accords in 1995, spent the equivalent of around 22% of GDP rehabilitating its four biggest banks the following year. But there was a second banking crisis in 1998-99 when two big banks and several others became insolvent, costing another 5% of GDP to sort out. In April 2000 there was a run on Bank Istarska, which the government halted. It was time to look abroad for buyers. Within a year three big banks had been sold to foreigners—IntesaBCI and UniCredito of Italy, and Germany's Bayerische Landesbank. A British investment fund, Charlemagne Capital, also bought three banks. That put around 90% of Croatia's banking assets into foreign hands. More nimbly than other countries, Croatia was outsourcing the recapitalisation and to some extent the supervision of its banking sector. Thereby hangs a tale.

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Rogue trader, rogue parent

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From The Economist print edition

Most of the banks in Central Europe have foreign owners. That is no guarantee that they will be well run

CENTRAL EUROPE has its own Nick Leeson or John Rusnak in the person of Eduard Nodilo, a dealer at Rijecka Banka, Croatia's third-biggest bank. Mr Leeson was the rogue trader who brought down Baring Brothers, a British merchant bank, in 1995; Mr Rusnak inflicted a $690m loss on Allied Irish Banks earlier this year. Mr Nodilo, for his part, accumulated $98m of foreign-exchange losses before they were discovered in February, wiping out the bank's capital. Like his western counterparts, Mr Nodilo had been hiding losses for several years. The market had noted that he was trading unusually high volumes, but the board of Rijecka Banka, when quizzed by regulators at the Croatian National Bank, said that everything was in order. Nor did Rijecka's parent, Bayerische Landesbank, ring the alarm bell—until it was too late.

So who was responsible? Bayerische Landesbank had bought the bank from the government two years earlier, which should have given it plenty of time to do due diligence. The bank had been valued by experts. The Croatian supervisors had overall responsibility to ensure the bank was properly run. But where there is a foreign parent, hard-pressed bank supervisors in Central Europe tend to rely on its usually more rigorous controls. In Europe, at least, the parent's supervisor tends to look at the whole group, including foreign subsidiaries.

Even so, the fraud at Rijecka remained undiscovered for a surprisingly long time. When it came to light, Bayerische Landesbank did a rapid internal audit and decided to sell the bank back to the Croatian government for one kuna (about 14 US cents). By disposing of its purchase for next to nothing, the German bank had lost its capital stake of around $70m. Even so, Cedo Maletic, a vice-governor of the Croatian National Bank, thinks it did not do enough: “Banks aren't shoes to be put in the garbage.” Bayerische Landesbank does not owe Croatia anything, he says, “but if it wants to buy another bank here—no chance.” Oddly, outside Croatia nobody took much notice of the bank's troubles.

Bayerische Landesbank owns another Central European bank, the Hungarian Foreign Trade Bank (MKB), in which it had bought a stake in 1994 and taken a majority in 1997. Through its affiliate, Bank für Arbeit und Wirtschaft (Bawag), it also has a stake in Istrobanka in Slovakia. Would it drop those too if they got into trouble? It argues that Rijecka was a special case—the fraud meant a time-bomb was lurking even before the government sold the bank.

A better class of investor

Foreign banks that have taken majority or even minority stakes in Central European banks are known as “strategic” investors, which means something more than a portfolio investor who buys and sells bank shares. Local regulators assume that strategic investors have a commitment to their affiliate, and that they aim to apply the same standards of ethics, governance and risk management to it as they do at home. There have been a few disappointments, but most Central European regulators think that in general this has worked. György Suranyi, a former governor of the National Bank of Hungary, says a risk remains, and there is a need for tight supervision, but “the bulk of the responsibility lies with the

strategic investor." He represents such an investor himself now, as head of multinational banking for IntesaBCI of Italy, which owns banks in Hungary, Croatia and Slovakia. The Italian and Austrian parent banks in particular, having built a network of banks in the region, insist that they stand behind their subsidiaries.

The Rijecka case was a disappointment because Bayerische Landesbank was not prepared to back its subsidiary when it got into trouble. The German bank had problems at home, as the biggest creditor to the troubled Kirch media group. It was also alarmed by initial reports that the losses at Rijecka could be far bigger than they appeared, and that the entire bank was crooked. However, in May it managed to sell Rijecka Bank to Erste Bank of Austria for about $55m.

Other retreats by strategic investors have been more understandable. Nomura Securities, which bought 40% of Investicni a Postovni Banka in the Czech Republic, was hailed at the time as a strategic investor. The Czech authorities even had a letter of intent from Nomura, undertaking to bring some expertise to the bank. But when IPB got into trouble, Nomura did not regard itself as responsible. After all, it is an investment bank. It was a lesson to the Czechs that they should find more appropriate strategic investors in future. They have done so with subsequent bank sales.

A handful of other foreign parent banks have been unlucky. Bankgesellschaft Berlin, in trouble because of its east German property portfolio, sold its Czech subsidiary, Zivnostenska Banka, to UniCredito of Italy in August. Kent Bank of Istanbul went bust in the Turkish banking crisis in 2001 and its Albanian subsidiary, National Commercial Bank, became the property of the Turkish government. That did not please Albanians, who had suffered Ottoman rule for centuries until 1913. Similarly, Demirbank in Romania was orphaned after its eponymous Turkish parent failed. It was bought by UniCredito. If subsidiary banks like these are well capitalised and properly supervised, there should be no problem finding another buyer if the parent gets into trouble. But the message to local supervisors is clear: they should not relinquish responsibility for the banks on their turf.

Polish supervisors are probably taking their strategic investors too much on trust. Several foreign-owned banks in Poland have a high level of non-performing loans—up to 60% in one instance—but a much lower level of loan-loss provisions. The shortfall tends to be guaranteed by the parent. "A lot of foreign banks don't meet the standards," says a local banker.

Second division

Several West European banks have shown real commitment to the region. Two Austrian banks, Erste Bank and Raiffeisen Bank, have become more Central European than Austrian. Erste owns the biggest savings banks in the Czech and Slovak Republics, employing nearly three times as many staff there as the parent does in Austria. It also has banks in Croatia and Hungary. Raiffeisen Bank owns Tatra Bank, reckoned to be the best private bank in Slovakia, and has subsidiaries in 12 other countries in the region. Other committed parents are KBC of Belgium, with CSOB in the Czech Republic and Slovakia, K&H in Hungary, Kredyt Bank in Poland and, subject to negotiation, 34% of Nova Ljubljanska Banka in Slovenia; UniCredito, with a big bank in Poland, Pekao SA, and others in Bulgaria, Croatia, the Czech Republic, Slovakia and Romania; IntesaBCI, with banks in five countries in the region; and Société Générale with Komercni banka in the Czech Republic, and others in Bulgaria, Romania and Slovenia. Allied Irish Banks owns two banks in Poland, which it has merged. It landed in that country almost by accident, having offered technical assistance to one of the banks under a World Bank programme.

However, none of these parent banks is in the first league. Central Europe tends to be the stamping-ground of second-tier banks. Where are the Citibanks, J.P. Morgans and Deutsches? And where are the British, especially HSBC, that emerging-market specialist? True, Citibank bought the biggest Polish corporate bank, Bank Handlowy, in 2000, and has been present in Hungary for 16 years. But even Citibank, and certainly other top-tier banks, have not been punching their weight in Central Europe. Perhaps they are planning to wait for a few years and then buy one of the Austrians or Italians along with their Central European network.

HypoVereinsbank of Germany, though not in the big league, did exactly that when it bought Bank Austria, which has a retail and investment-banking network in most Central European countries, having itself merged in 1997 with Creditanstalt of Austria, one of the pioneers of banking in Central Europe. ABN Amro, a Dutch bank, merged its Hungarian bank with one owned by KBC in a joint venture which is now under KBC management.

There will undoubtedly be further consolidation of banks in the region, either because their parents merge or because they sell out. According to Wojciech Kostrzewa, chief executive of BRE Bank in Poland, “You need a market share of 10-20% in markets which aren't artificially regulated. Most banks here are too small.”

Mr Kostrzewa expects more departures like that of ABN Amro from Hungary (see article). BRE Bank, the region's only self-proclaimed indigenous investment bank, expects to be involved as a dealmaker. BRE Bank is 50% owned by Commerzbank, one of Germany's universal banks. It is involved in some Polish industrial workouts, such as bankrupt Elektrim, which is feared to be eating into its risk ratios. Would Commerzbank stand behind BRE? Eyebrows have been raised in the banking community at BRE's readiness to take equity stakes in companies, while funding itself with short-term retail deposits. “He's running his bank like a hedge fund,” says a local investment manager of Mr Kostrzewa. But auditors and supervisors seem happy, one even calling BRE“the best-run bank in the country”. The risk ratios look all right, say correspondent banks grudgingly. Mr Kostrzewa complains that he is singled out because no other bank is taking equity risk. He sings the praises of the British merchant banks of yesteryear, and of Mediobanca, which restructured corporate Italy in the 1950s and 1960s.

Croatian supervisors are less than delighted by the presence of Charlemagne Capital, a British-based manager of equity funds, which has been able to build up and control a considerable banking group in Croatia. Charlemagne, until last year known as Regent Europe, bought its first two Croatian banks, Dalmatinska Banka and Istarska Banka, in 2000 from the government's bank rehabilitation fund. The national bank supervisors had no control over the sale. Charlemagne has since added another regional bank and will merge them all, moving the headquarters to Zagreb and calling it Nova Banka.

Charlemagne has no obvious banking expertise, apart from a similar control of Hebros Bank in Bulgaria. Alarmingly, after buying the Croatian banks it stopped their operations for a while, which cannot have been good for business. Charlemagne's declared strategy is to improve the banks and resell them in three to seven years. Meanwhile it is bidding for another Bulgarian bank, Biochim.

Taking the rough with the smooth

Foreign non-banks may not be the ideal parents for Central European banks in transition, but then countries cannot always be too choosy. The first bank that Hungary sold control of was Budapest Bank, in 1996, to GE Capital. “The deal was badly structured and included political involvement,” recalls someone close to the sale. The new owners severely reduced the bank's product range and turned it into little more than a consumer finance house. GE Capital is reckoned to have made plenty of money, but it did not shower the market with new products and credit cards, as the sellers had hoped.

The EBRD has invested in the equity of more than 80 banks in transition countries, usually accompanying a foreign strategic investor. It sees this as a vital part of its job, although it has had to be pragmatic about some of its business partners. “If we don't like what we see, we just withdraw from the board,” says Kurt Geiger, director of the financial-institutions group at the EBRD. In many cases it has sold its stake once the bank is on a steady path.

For the time being these banks, answerable to foreign parents, are the dominant source of finance in these economies. That is not strictly healthy. Debt financing can be fickle in times of trouble. Foreign owners may suddenly lose interest in the local economy and decide to put their resources elsewhere.

For now, these countries are relying too heavily on these foreign-owned banks to provide their working capital. In principle, local sources of capital—securities markets, pension funds, insurance companies—are available. But as yet they do not offer a real alternative to the banks.

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In and out

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ABN Amro's Central European excursions

ABN AMRO, a big Dutch bank, has a tradition of venturing into wild places in pursuit of customers. In the early days of post-communist transition it was everywhere. In 1996 it bought Hungarian Credit Bank (MHB), and invested a huge amount refurbishing its branches. Even in the smallest provincial branch, everything had to be done ABN Amro's way, down to the office furniture imported from the Netherlands and expensive IBM hardware.

The management style too was imposed from Amsterdam, although the bank hired good local people. Accustomed to operating in former Dutch or British colonies, ABN Amro prefers to send out “soldiers” from head office. Whether those soldiers are good or bad, they usually stay for no more than three to five years, and are often preoccupied with office politics and promotion prospects back home.

Despite this weakness, ABN Amro had an expanding business in Hungary, as well as in Poland, where in 1996 it sent a good Dutch soldier as country manager. He persuaded his bosses in Amsterdam that ABN Amro should buy a Polish bank. It had already looked at BPH, a medium-sized corporate bank in 1994, but balked at the price, and BPH was floated on the stock exchange the next year. By early 1998 ABN Amro was all fired up to buy it. But a change of management in Amsterdam and losses from financial crises in Russia and Brazil made it hesitate, and the Polish bank was snapped up by HypoVereinsbank of Germany. The blow to morale at ABN Amro in Warsaw has since caused key staff to leave.

Meanwhile, in Hungary, ABN Amro Magyar Bank lost money every year from 1995 to 2000, according to former staff. In July 2001 ABN Amro struck a deal to merge ABN Amro Magyar Bank with K&H, owned by KBC, a big Belgian bank. KBC staff ended up holding most of the key posts. In effect, ABN Amro had pulled out of Hungary.

Observers think ABN Amro may have been a victim of its own successful recruitment. Among its alumni is Zsigmond Jarai, a former finance minister and now the president of the National Bank of Hungary. The current finance minister, Csaba Laszlo, managed the merger between ABN Amro's bank and K&H. Another former ABN Amro manager is now chef de cabinet to the prime minister, Peter Medgyessy. Two of the bank's senior expatriate managers moved to Citibank and Raiffeisen Bank respectively. Another Hungarian alumnus runs Raiffeisen Bank in Belgrade. ABN Amro seems to have played an important part in the development of Central European banking without getting much of either the benefit or the credit.

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Capital punishment

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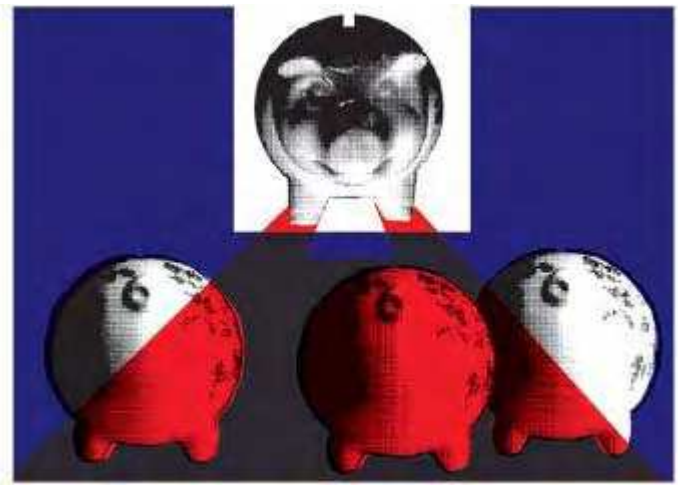
From The Economist print edition



Troubled local stockmarkets are looking west for allies. Many of them will not survive

WOOD & COMPANY claims to be Prague's biggest equity broker. It used to be even bigger, boasting offices in Poland, Hungary, Slovakia and Ukraine as well as in London and Istanbul, but that was before equities had felt the full effect of the Russia crisis of August 1998, which sent a shock through capital markets around the world. Now Wood has shrunk to two locations, Prague and Bratislava, although it still does some cross-border business. Richard Wood, the founder, has long since moved on.

Most stockmarkets around Central Europe are dying. In Prague, there has not been an initial public offering (IPO) of shares since the 1930s, even though thousands of companies were listed in the 1990s during the mass privatisations. The Czech stockmarket is not a place to raise new capital. Over 100 companies are still listed, but only a handful are actively traded, none of them blue-chip names.

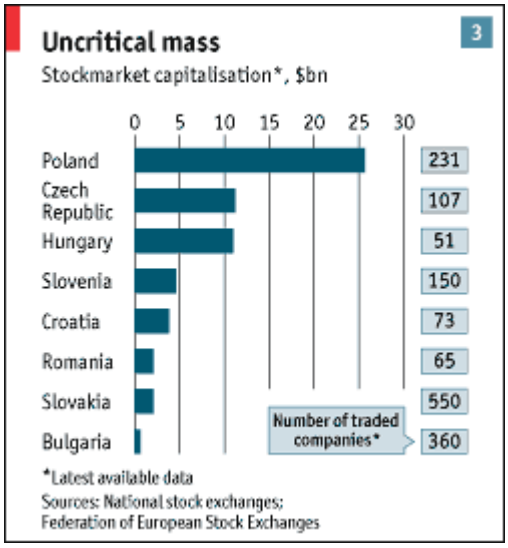
Hungary's stockmarket is marginally better. It does have some blue chips, such as Mol, an oil company, Matav, a telecom company, and OTP, the country's biggest bank. It has even had some proper IPOs, though the last one, of Synergon Information Systems, was in 1999. Volumes are still desperately low. “I'm afraid Hungary will go the way of the Czech Republic,” says Petr Koblic, chief executive in Prague of CAIB, the investment bank of the German HVB group.

In Belgrade the technocrats—some of them former bond traders at Wall Street firms—have decided, sensibly, that equity markets must wait until Serbian companies have become more transparent. Meanwhile, they are building a government bond market. A corporate bond market may follow.

Arguably, the only equity market in the region that is big enough to be sustainable is Poland. The Warsaw Stock Exchange has a market capitalisation of around $26 billion, more than all the neighbouring stockmarkets combined. With a population of nearly 40m, Poland would expect to have bigger companies, bigger investment institutions and a bigger number of retail investors than its neighbours. Romania, the next most populous country in the region, with around 22m, should be able to sustain a national stockmarket too, but it is a long way behind Poland, Hungary and the Czech Republic.

And even in Poland, there are doubts whether a national stock exchange can survive European consolidation. Turnover has

dwindled to $25m a day. Belgium, France and the Netherlands have already merged their stockmarkets to create Euronext. The Warsaw Stock Exchange has signed a cross-marketing agreement with Euronext, but has made no commitment to join up. Being 98% owned by the Polish treasury, it cannot take such a decision on its own. But by the end of this year Wieslaw Rozlucki, chief executive of the exchange, should be able to agree with the treasury on whether to look for a strategic partner, or whether to slug it out alone. There have been proposals for a regional exchange based in one of the bigger countries, but Mr Rozlucki thinks that is a bad idea. The market would lack critical mass, he claims, pointing to Vienna's attempt to become a hub for Central European stocks. A Viennese exchange, Newex, aimed at regional companies, was actually traded electronically in Frankfurt—and proved a failure: it has just been absorbed by the Frankfurt exchange.



Great expectations

Perhaps too much was expected of Central Europe's fledgling stock exchanges. An American agency, US Aid, spent millions of dollars on projects to establish capital markets in a post-communist wasteland. But setting up a stock exchange is one thing; creating the necessary conditions for an active equity market quite another.

A healthy stockmarket needs transparent reporting by companies, good corporate governance and a respect for shareholders' rights. Those conditions often lag a long way behind the launch of share trading. Second, it has to have a domestic investor base. Too often, nascent stockmarkets have attracted a flood of speculative investment from abroad, only to see it disappear at the first hint of trouble. The obvious answer is to build a class of institutional investors, starting with pension funds, and to encourage mutual funds and private portfolio investors. Third, listing on an exchange must be attractive to companies. Many smaller businesses are deterred by the cost and the disclosure requirements. Fourth, the underlying economy should have a track record of reasonable stability. In many countries a flurry of equity mania in the early 1990s was followed by high inflation and a stockmarket bubble which severely damaged the value of investments.

Poland is ahead in the game because it avoided a market bubble, and took trouble to build up pension funds. Since 1999 all employees born before 1969 have been obliged to contribute 9% of their salary, of which a portion goes into private pension funds. That has produced funds totalling around $6 billion so far. Some 40% of that money can be put into equities, of which 5% may be invested abroad. That gives the Polish market a predictable expansion of its equity base, encouraging other investors to come in too.

Hungary reformed its pension system in 1998, but its pension funds are growing only slowly in a thin equity market. Many companies were sold to foreign investors rather than being listed on the Budapest Stock Exchange. However, there were some landmark IPOs, starting with Danubius in 1992. The government also chose to list Mol and OTP rather than sell stakes to strategic investors.

The Czech Republic, having seen many privatised companies delist for lack of investor interest, might be able to revive enthusiasm by floating a small equity slice of companies it has privatised recently. Erste Bank of Austria, having completed its takeover of Ceska Sporitelna, the big local savings bank, had to delist the stock, but intends to fill some of the gap by issuing its own shares on the Prague market in October. Traders are sceptical that this will add much liquidity locally. Share trading will gravitate to the market where a company's shares are most heavily traded. Although the region's blue chips, such as Mol and Poland's KGHM, are listed in London or Luxembourg, the share price is still determined locally and most of the trading is done on the spot.

However, because of the consolidation of exchanges in Europe, and the growing share of institutional trading, Central European exchanges will be increasingly isolated unless they have links into the West. Mr Rozlucki at the Warsaw Stock Exchange accepts that Poland's blue chips may migrate to a multinational exchange, and that Warsaw should be part of a wider structure. But for small and medium-sized companies, he believes disclosure of corporate information, price discovery and the surveillance of companies and brokers will stay closer to home. The Warsaw exchange is in with a fighting chance “if we can provide alternative sources of capital”, says Mr Rozlucki.

Local attractions

Jan Sykora, a partner at Wood & Company, believes there will be a role for local regulators as "gatekeepers to the global market". But he is sceptical whether, eventually, local listings will work "when there's so much consolidation of asset managers and investors". Warsaw may retain more local interest, but on the Prague exchange 99.5% of the trading volume is institutional orders and 95% of those are from abroad, says Mr Koblic at CAIB. Slightly more promising is the Czech Republic's corporate bond market, which is bigger than Hungary's, Poland's and even Spain's (see table 4). But it reflects the fact that Czech companies have great difficulty raising bank loans: in 1999-2000 they repaid more to local banks than they borrowed.

One thing that would help the region's stock exchanges is progress on corporate governance. Shareholders' rights continue to be abused. An inadequate legal system means that redress takes years, so most people do not pursue cases. A company's management "can still present an illegal action to shareholders and get away with it", says an investment banker in Prague.

Backward bond markets 4

Outstanding domestic debt securities as % of GDP end 2000

	Financial	Corporate	Total*
Germany	49.7	1.3	90.2
Portugal	16.1	9.6	61.7
Spain	5.3	4.8	59.0
Czech Rep.	5.5	5.3	46.1
Hungary	na	1.5	35.5
Poland	na	0.0	20.3

Source: European Investment Bank *Includes public bonds

The worst abuses of the early days involved companies and the government-inspired national investment funds stripping out assets under shareholders' noses—"tunnelling", as it was called. Another common peccadillo was for strategic investors to pay a premium for a controlling stake in a company without making a general offer to shareholders. Mol, the Hungarian oil company, did this when taking over Slovnaft, its counterpart in Slovakia. "At that time no full bid was required," parries Zoltan Aldott, head of strategy at Mol, and also a board member of the Budapest Stock Exchange. "If we increase our stake now, we will make a public offer."

Would you do this at home?

HypoVereinsbank, a German bank, paid the Polish treasury more than twice as much per share for Bank Przemyslowo-Handlowy (BPH) than it paid minority shareholders. ING, a Dutch bank, took a majority stake in Bank Slaski, another Polish bank, then made huge provisions on the balance sheet, depressing the share price before buying out the minority shareholders. These foreign companies were taking advantage of lax local regulation to do things they could not get away with in their home countries.

Poland now has two committees working on corporate governance. In Romania the chief executive of the Bucharest stock exchange, Sergiu Oprescu, has started a new category of listing for super-compliant companies, called the "transparency-plus tier". Two have applied, but so far neither has achieved the upgrade.

Raimondo Eggink, a Dutchman, led the first legal challenge by minority shareholders in Poland, against Michelin of France for unfairly transferring profits from its listed local subsidiary, Stomil Olsztyn. In 1999, he also sued a Polish company for paying a premium to shareholders with a stake of more than 1% when it delisted its stock. In fact, the company was acting within the law, but Mr Eggink claims that the law in question is unconstitutional. The case has been in the High Court for a year and a half. "If it's thrown out, I'll take it to the Constitutional Court," he says stoically. "I'm doing it for fun." He is paying his own legal costs, which so far have been modest. It seems that Mr Eggink's activism has won sympathy in high places: the treasury recently made him a member of the supervisory board of the stock exchange.

Perhaps it was too much to expect Central European countries to develop mature and properly regulated securities markets within a few years when it took centuries to develop them in the West; and given the poor examples of corporate governance offered by Enron and a growing list of other western companies, it seems that even mature markets are no guarantee against abuse. But there is an alternative way to encourage an equity culture in the region: direct private investment in unlisted companies.

Horizonte Venture Management, a small private equity firm in Slovenia, has had two investment failures. In the first, it backed a company that had no international market for its product. The second was due to a scam: a Slovenian firm it invested in bought overpriced, inappropriate machinery from an Austrian entrepreneur, which he had found second-hand in the Czech Republic. But apart from those, Horizonte has done well, venturing first into Slovenia, then Bosnia & Hercegovina and finally Croatia. In 1992, when

Slovenia was only a year old and its continued independence looked shaky, Horizonte was having trouble raising money for a Slovenian fund. A Dutchman at IBM's pension fund came to the rescue. He had been to Slovenia and judged that it was already the best-run economy in Central and Eastern Europe.

Private equity can enter these new market economies early because it requires little infrastructure—just an agreement between investor and entrepreneur. If the investor has found the right person the business grows, and within three to seven years it is sold to an acquisitive company, or listed on the local stock exchange.

A lot can go wrong, and hand-holding is essential. The entrepreneur may need help with developing foreign markets, raising fresh capital or taking out patents to protect his product. A hands-on private equity firm like Horizonte gets involved at this working level, as well as trying to ensure the company is run according to standards the investors demand. Apart from good corporate governance, the usual stipulation is no drugs, no arms and no prostitution. As it happens, a drug company of the legal kind is one of Horizonte's most promising Slovenian investments: Transcell, a pharmaceutical firm with ambitions to become a world leader in the treatment of tumours.

Serial entrepreneurs

The challenge for private-equity investment firms is to find a certain kind of entrepreneur who is skilled at building up a business, but not set on preserving it as a family heirloom. “Private equity breeds a class of serial entrepreneur,” says Pierre Mellinger, who runs AIG-CET Capital Management (Poland) in Warsaw. As yet, those entrepreneurs cannot be too picky about their source of funding in the region. In essence, their choices are to find the finance themselves, take a bank loan or team up with a private equity investor. The leadership provided by this new class of entrepreneur is very important for an economy, says Kurt Geiger at the EBRD.

Poland is the most popular place for private equity investment because it has the biggest population, but that may be short-sighted. Miroljub Labus, the deputy prime minister of Serbia, is striving for a customs union of those Central European countries at the back of the queue for EU accession. This should create a bigger internal market and attract more foreign direct investment, he argues. But finding good managers is a challenge, and anyone over 45 is usually too set in the nannyish ways of central planning to run a competitive business. “We need a new breed of people who will take the risk of making decisions,” says Dan Pascariu, who used to run the Romanian Foreign Trade Bank and now heads a German bank subsidiary, HVB, in Bucharest. “We all carry too much baggage; the 26-year-olds don't.”

The EBRD has invested in more than 80 private equity funds over ten years and has made about 800 separate investments. To have the bank on board is good for marketing one's fund, says Piotr Bardadin, who runs Renaissance Partners in Warsaw, and investors like its insistence on high environmental standards. The EBRD has found that the bigger funds tend to do best, perhaps because they have more resources for doing due diligence and carry more clout with host governments and with the companies they invest in. The EBRD's internal rate of return on its investment in these funds is in the high teens, says Mr Geiger. It has its own equity portfolio too, much of it invested in banks. Apart from a few bank failures in Russia, Estonia and Latvia, the banking portfolio has done well, providing the EBRD with an internal rate of return of around 20% a year since its first investment in 1992.

Enterprise Investors (EI), based in Warsaw, is the biggest and earliest private equity manager in the region, with around $4 billion-5 billion under management. Its boss, Jacek Siwicki, was at the privatisation ministry in the heady days of mass privatisation. EI's charter allows it to invest 30% of its funds outside Poland. It has made investments in Romania and Slovakia. Mr Siwicki thinks that private equity in Central Europe is not that far behind practice in the EU or even North America, where private equity funds started in the 1970s. The challenge is to find an exit, given that even the Warsaw Stock Exchange is not a great place for IPOs (although EI recently floated a jewellery business for about $4m). The company has recently done well with sales to strategic investors: it sold a small-business bank to Fortis and a mortgage bank to GE Capital.

Private equity is not always the best tool. There is room for other kinds of venture capital in the region, for entrepreneurs or business owners who do not want to give up equity. The EBRD has teamed up with Mezzanine Management to launch a fund for mezzanine finance—development capital in the form of high-yield debt, often with some equity characteristics. Accession Mezzanine Capital, with *euro*75m in its kitty, is aimed not at entrepreneurs directly, but at private equity funds dealing with entrepreneurs who want to keep their business.

During a decade of assisting transition in Central Europe, development agencies such as the EBRD, the World Bank, the European Investment Bank and Kreditanstalt für Wiederaufbau have increasingly concentrated on helping small businesses get bigger. Now even those banks that started off by financing corporate giants and masterminding mergers and acquisitions have turned their sights to small and medium-sized enterprises. That can only be good for those who want to start their own business.

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Back to nursery school

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Small-business finance is at last beginning to get the attention it deserves

THIS is how a small business died. Fifteen years ago, Aniko, a blonde, feisty mother of two, worked for one of Hungary's centralised foreign trade organisations (FTOs), selling honey to Western Europe. She was one of the privileged few who travelled to trade fairs and socialised with foreign buyers. When the FTO closed in 1991, she was left jobless and began to sell honey herself, using her contacts with beekeepers and foreign clients. But she needed finance to bridge the gap between buying the honey and getting paid herself. One Hungarian bank obliged, charging interest at 37.5% and taking the family house as collateral. Business improved, interest rates came down and Aniko had a nice little earner—until 1999, when the EU began to dismantle its tariffs on agricultural imports from Central Europe. The duty on Hungarian honey was cut from 16% to 10%. But, rather unfairly, the duty on Czech, Slovak and Romanian honey went down from 16% to zero.

Hungary's beekeepers protested. If only they had kept their mouths shut. Their protests alerted the banks, which decided they could no longer lend to the honey trade while Hungary had "this international honey problem". Aniko's bank, K&H, a Hungarian subsidiary of KBC of Belgium, refused to provide finance, even when she produced a firm order from a loyal German buyer. Unfortunately she had already spent the 16m forints ($63,000) she would have made on the German deal, so she had to let down the beekeepers, close the business and remortgage her house. Now she is selling honey again, but on 2% commission.

Starter packs 5

Micro-and small lending, April 2002

	Project	Amount of loans outstanding $m	Arrears >30 days, % of loans outstanding
Albania	FEFAD Bank	15.4	3.44
Bosnia	MEB	19.2	0.92
Bulgaria	Procredit	10.9	0.00
Kosovo	MEB Kosovo	11.6	0.16
Romania	Romania MFI	5.8	0.75
Russia	RSBF	156.5	0.81
Yugoslavia	MFB	10.9	0.30

Source: European Bank for Reconstruction and Development

Of course every bank must stick to its credit policy. There may have been good reasons why K&H could not lend. But undoubtedly many small businesses are being starved of finance in Hungary, Poland, Slovakia and elsewhere, simply because they do not meet inflexible credit criteria.

In Serbia, the surviving banks—after the closure of 23 in the past year—are awash with deposits, but they are not inclined to lend to small businesses, says Mladjan Dinkic, governor of the central bank. "One reason is the potential risk, but they also don't have the skills to evaluate credit." The same is true of most banks in the region, although their foreign strategic partners are beginning to change that. The danger is that credit-point-scoring systems of the sort used by banks in the West are too crude to fit individual circumstances.

Nursing small and medium-sized entreprises (SMEs) in Central Europe to create a much-needed *Mittelstand* is still too labour-intensive to be profitable: it needs technical assistance and some subsidy. Some help has been forthcoming from America, not least because of a perceived need to keep Central Europe onside: after all, much of it is run by retooled former communists. In 1989 America's Congress voted to set up the Polish-American Enterprise Fund, which pioneered the development of smaller businesses in the region. By 1994 it had invested around $200m. It was followed by the Russia Small Business Fund, and similar funds for Bulgaria, Romania and countries in the Caucasus. When America's treasury secretary, Paul O'Neill, attended the EBRD's annual meeting in Bucharest in May, he made a point of visiting a small furniture factory nearby that had been given a small-business loan.

Even the countries in the first wave of EU accession need more small-business finance. But Peter Felcsuti, managing director at Raiffeisen Bank Hungary, warns against a one-size-fits-all concept for the region: "In Poland, a company with *euro*5m in sales is treated as an SME, whereas in Hungary, because of the competition between banks, even a *euro*2m company can get special service as a corporate borrower."

The EU's Phare programme channels funds into small-business lending via the EBRD and other European financial institutions. Without the right incentives the banks can suddenly pull the plug. The EBRD's programme, which started at the end of last year, opens lines of credit to local banks that sign up. The EU pays for technical assistance. There are grants to help with such things as marketing and training loan officers. The maximum loan is *euro*250,000, and the average around *euro*25,000, but two-thirds of the total number are micro-loans—anything from $50 to $10,000. There is an incentive scheme for the banks: if their portfolio performs well, they get a funding subsidy of 3.4-5.5% from the EU, depending on the size of the loan. “Our biggest concern,” says Charlotte Ruhe, who runs the EU-sponsored scheme at the EBRD, “is that the subsidy should not be passed on to the borrower. That would distort competition.”

So far the EBRD has signed up 23 banks in the ten accession countries. About *euro*180m has been lent. More important, the average response time for applications from borrowers has come down from a month to five days. The most enthusiastic bank, says Ms Ruhe, is Bank Zachodni WBK in Poland, whose management is committed to the project and has trained loan officers in 300 branches. In the Czech Republic, experts from Shorebank, a small-business bank in the Chicago region, are helping Ceska Sporitelna run its SME lending programme. The bank tried to expand into small-business lending ten years ago, with disastrous results: it had to be bailed out. But under its new owner, Erste Bank of Austria, it is now flush with deposits and trying to broaden its loan portfolio.

Although securing loans is important, “we try not to turn down a loan that is not based on collateral,” says Gretta Larson, a Shorebank expert working at Ceska Sporitelna. Recently the Czech Republic amended the law to permit a lien on movable collateral such as machinery and other capital goods. Neighbouring Slovakia has also passed a new law, based on American practice, which from January 2003 will allow machines, cars, furniture and even intellectual property to be used as collateral. That puts it ahead of most European countries using Napoleonic law, says Katarina Mathernova, an adviser to the government.

The European Investment Bank (EIB) also assists small business through its “global” loans. Unlike the EBRD, which adds technical assistance and monitors each project locally, the EIB tends to push out the money from its headquarters in Luxembourg and trust the local banks to run the projects. As a safeguard, it usually chooses banks whose shareholders include the EBRD, the International Finance Corporation (an affiliate of the World Bank) or Kreditanstalt für Wiederaufbau (KfW), or it lends through the central bank, with a sovereign guarantee. KfW also has a programme of its own, which is slightly cheaper than the EBRD's. The EIB undercuts them both.

Think small

When Elizabeth Wallace was working for the EBRD in the early 1990s, she was struck by the wastefulness of closing down big chunks of the communist world's arms industry without helping the newly unemployed to start new businesses. The EBRD's minimum loan in those days was $15m. An out-of-work munitions worker might have needed a loan of $10,000 to start growing mushrooms in the factory where he once made bombs, says Ms Wallace. Another $10,000 could have started a business cutting up redundant battle tanks. Yet none of this was being done.

Against opposition within the EBRD, notably from Ronald Freeman, the vice-president, Ms Wallace—who is now director for small-business finance at the bank—raised $150m from G7 governments to start the Russia Small Business Fund. Pilot projects in Russia were successful. Losses have been minimal: during the 1998 crisis, when the government defaulted on its debt, “we lost some banks [which went bust] but we kept the clients,” Ms Wallace says. One good thing about micro-loans is that the mafia, which to varying degrees is active throughout Central and Eastern Europe, is not interested in taking a cut of such small-scale business.

The EBRD's micro-lending programme, which is now well-established, channels lines of credit to local banks specially set up for the purpose. To date the bank has mobilised $500m of small loans to the region. There are micro-lending banks in Albania, Bosnia, Kosovo, Moldova, Russia and some Central Asian countries. The performance of these banks depends almost entirely on the quality of the loan officers, who must identify good potential borrowers, understand their psychology and keep them motivated.

Collateral is the stumbling-block for most small-business lending. What can a borrower pledge when starting from zero? Ms Wallace's team sought advice from the World Bank and from micro-banks in Indonesia, Mozambique and elsewhere, and found that almost anything will serve as collateral, provided

it means a lot to the borrower. It could be a cat, a cow or a treasured fur coat, but preferably a house. As long as the borrower is determined to hold on to the collateral, he or she will probably go on servicing the debt. In most countries the arrears rate has been remarkably low, under 1%. Even in Albania, where a pyramid scam hit thousands of people, the arrears amount to only 3.4% (see chart 5, previous page). The Micro-Enterprise Bank in Kosovo is thought to be the most profitable in Central and Eastern Europe.

In the 1990s many international banks were trying to reduce their loan books and concentrate on fee income from corporate finance and the more affluent clients. Now some have decided that they were wrong to neglect retail and small-business lending. That should make life easier for small borrowers like Aniko.

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Inconspicuous consumption

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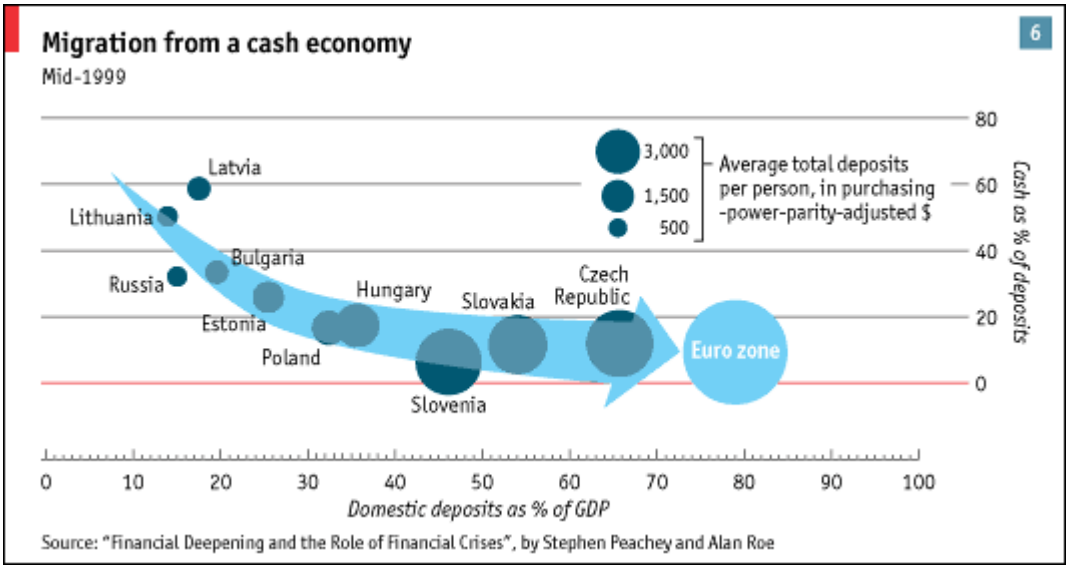
Suddenly everyone wants to harness the power of consumers. But they are still thin on the ground

PETER KISBENEDEK used to sell insurance. Before that he was in white goods. Perhaps he is just the man to bring a fresh approach to retail banking in Hungary. Austria's Erste Bank must have thought so, because it hired him in 2000 to run its small bank there.



Small, but getting bigger. Erste had bought three small Hungarian banks in the late 1990s and merged them under its own name. At the end of 2000 it had around 1.8% of the retail market. Mr Kisbenedek saw a gap in the provision of mortgages and sold them hard. He is convinced the mortgage market will grow, and Erste Bank with it. By April 2002, Erste reckoned its share of the retail lending market in Hungary had grown to 4.3%.

It also opened lots of new branches on the cheap—ten in Budapest last year, at an average cost of *euro*200,000 a time. Even no-frills Erste used to spend ten times that on opening a full-service branch. Most of the new branches are in shopping malls, where the infrastructure is already in place, and each has a staff of only four, all of them salesmen. Credit decisions and processing are handled centrally. The

bank is prepared to close branches that do not work—"like shoe shops", says Mr Kisbenedek. By the end of 2002 Erste plans to have 35 branches in Budapest and other big cities, and will be storming towards the 20-25% share in retail banking and 8% share in small-business lending that it believes it needs to become a force in Hungary. To get there faster, it will probably try to buy another bank.

But the retail market in Hungary is getting cluttered. Even banks that previously had no interest in this particular sector now see the attractions of a sophisticated and increasingly affluent clientele. They include Citibank, Raiffeisen Bank and Central-European International Bank (CIB), which previously concentrated on corporate banking. The retail market is already the stamping-ground of Postabank, Budapest Bank (owned by GE Capital), K&H Bank (owned by KBC) and HVB Bank of Germany, all dominated by OTP, the big savings bank, "like Snow White and the seven dwarves", says a competitor.

Erste is going for a market share of above 20% in several Central European countries. In the Czech Republic and Slovakia it has two sister savings banks, Ceska Sporitelna and Slovenska Sporitelna, which are already market leaders. In Croatia, adding Rijecka Bank to the three banks it has already bought and merged should bring it close to a 10% share. Several other European banks, mainly Austrian and Italian, have similar plans for the region.

This is in marked contrast to European banks' strategies for the euro zone, where cross-border bank mergers have so far been rare. Is there some reason why a retail presence straddling several countries should work better in Central than in Western Europe?

Certainly the market is less mature. For retail financial services, Central Europe is almost virgin territory. Mortgages are only one of the products that have started from scratch. Others include leasing, credit and debit cards, asset management, securities broking, pensions and insurance. Ownership of private property is still underdeveloped in Poland, compared with countries such as America or Britain, says Pierre Mellinger at AIG-CET in Warsaw. The Poles mostly keep their wealth in disposable assets such as cars.

Until that changes, building up capital markets and investment products there will be difficult. Improvements to legal systems and bankruptcy procedures would help, by providing more incentives for private and corporate borrowers to repay their debts. It would unlock chains of inter-company debt, as well as weaning banks off the easy option of keeping big chunks of their balance sheet in (supposedly) risk-free government bonds and encouraging them to take more credit risk. "If small-business lenders are experiencing only 1% of bad debts, it seems to me the banks aren't taking enough risk," says Paul Cunningham, a partner at PricewaterhouseCoopers in Prague.

The banks operating in former Yugoslavia face a special challenge. Companies there have been able to make their payments via a central system called Zop where they keep their accounts. Until Zop is dismantled, it will remain hard for banks to build an account relationship with corporate customers.

Under the mattress

Banks in Croatia, Slovenia, Serbia and a number of other countries had a one-time chance to gain more customers towards the end of 2001, just before the introduction of euro notes and coins, when thousands of accounts were opened to convert D-marks into euros. Much of this money had been sitting in shoe-boxes and under mattresses for years. According to one estimate, a total of *euro*4 billion-8 billion was converted and deposited in Serbian banks, but most of it was whipped out again soon after January 1st. Raiffeisen Bank's three branches in Serbia took around*euro*83m of extra deposits during that period. In Croatia, banking assets reported at the end of the year had grown by 33%, "mainly because of the euro conversion," says Ljubinko Jankov, head of research at the Croatian National Bank.

It is reassuring that there is this extra wealth lurking under mattresses. But in Serbia, for instance, it means that there may be up to *euro*8 billion lying idle and not working for the economy. Foreign-owned banks have been better at making such one-time deposits stick. Raiffeisen suffered no net outflows, and attracted more deposits until the May 31st deadline.

A study by the EBRD on bank reform, looking at 515 banks in 16 transition countries, shows that reform does not necessarily increase lending to customers. Often the government bond market takes precedence, crowding out private borrowers.

In the Czech Republic, Slovakia, Hungary, Bulgaria and Macedonia, the ratio of domestic credit to GDP is

between 68% and 103%. Everywhere bar Slovakia, it is well below the ratio found in other market economies at a comparable stage of development. Worryingly, in Poland, Croatia and even the highly westernised Slovenia the ratio is below 40%. At the present rate of asset growth, it would take Poland 141 years to reach a level appropriate for a market economy, according to the EBRD.

The study suggests that foreign-owned banks are no better at beefing up their loan books than state-owned banks or locally owned private banks, but their cost-effectiveness and productivity are higher. In general the presence of foreign banks, or banks with strategic foreign partners, appears to have increased competition and brought down charges.

Looking ahead

In another ten years, the banks that are beginning to dominate the region will probably have been acquired by larger international financial groups like Citigroup, Société Générale or Goldman Sachs—perhaps even Axa or Aviva. By that time, most Central European countries will be using the euro and will have become part of a vast financial market akin to that of the United States. There will be continent-wide brands of consumer finance and also, with luck, sources of finance for local small business. Shares in the major companies will trade only in the big centres, such as London, Paris and Frankfurt, but many more people in Central Europe will take their savings out from under the mattress and put them to work in the financial markets, whether in bonds, shares, private pensions or mutual funds. Their countries will be striving for better corporate governance, more transparency in politics, commerce and the law, and sounder regulation. The cities of Prague, Warsaw and Budapest will have taken their place beside Paris, Vienna and Berlin.

But things could still go wrong here and there. There is the election in Slovakia on September 20th and 21st, which probably won't, but could, put Vladimir Meciar back in office, throwing doubt on Slovakia's membership of NATO and the EU. There is the unresolved dispute between the Czech Republic and Germany over the expulsion of Sudeten Germans from Bohemia in 1945. And there are the shifting Balkans, where ethnic feuds are not necessarily dead and buried.

Existing or incoming governments in Central Europe could reject the conditions for EU entry, which would take the accession process off course. And even once the new countries are in, EU membership may not prove the panacea they had hoped for. An EU and a eurozone enlarged by perhaps ten members will be even more unwieldy and less sensitive to national priorities. There could be strains that encourage thoughts of a voluntary exit, or the expulsion of an errant government if other sanctions do not work. No one has yet dared write that into a treaty but, with 20-plus members, the time may come.

The biggest change required in the transition countries of Central Europe is in people's attitudes of mind, and that will take time. Silviu Brucan, one of Romania's great survivors—a former adviser to the dictator Nicolae Ceausescu, but no poodle—in 1989 told *Le Figaro*, a French newspaper, that it would take 20 years for Romanians to learn about democracy. “I was sued for offending the dignity of the Romanian nation,” he recalls, “but now they say I was an optimist.”

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White-collar crime in America

Out to catch the big fish

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How goes the war against corporate crooks?

AMONG the underpaid and overworked lawyers who make their careers in public prosecution, there is one job that can make a lifetime of slog worthwhile: US Attorney for the Southern District of New York. So when James Comey told his wife that the White House had telephoned to offer to uproot them and their five children from Virginia to Manhattan, she burst into tears. “You can't say no,” she told her husband. “I didn't,” he replied.

Mr Comey was previously appointed to work in the attorney's office when Rudolph Giuliani, celebrated former mayor of New York, was its boss. Then it was running a collection of headline-grabbing insider-trading cases that helped to refine Wall Street. Nine years later, Mr Comey finds his old office at another historic juncture. The bursting of the stockmarket bubble of the late 1990s has exposed abundant evidence of accounting fraud. A new and broader-based investing public has lost an awful lot of money. The perpetrators appear to have pocketed tens of millions of dollars. Confidence in the fairness of America's capitalist system is said to be at risk. Heads have to roll.

Mr Comey's office is not running every current big corporate-fraud case. Because of potential conflicts of interest among prosecutors in Houston, the bulging file on Enron has been given to a national team of prosecutors run by the Justice Department in Washington, DC. Certain tax aspects of the case against executives at Adelphia belong to the US attorney's office in Pennsylvania, where the company has its headquarters. But Mr Comey's office has claimed the lion's share of the work.

Its 230 prosecutors are responsible for WorldCom, which allegedly disguised deteriorating results through massive accounting fraud; the important bits of Adelphia, a publicly owned firm whose founding family helped itself to riches; and ImClone, a biotechnology start-up run by a Manhattan socialite whose alleged insider trading ensnared Martha Stewart, America's doyenne of soft furnishings (see article). More cases may follow, including Sunbeam, a bankrupt home-appliance company whose former boss, Al “Chainsaw” Dunlap, has been accused of cooking the books.

That these cases are only just beginning to show public signs of progress (see article) has been a source both of anxiety for Justice Department officials and of political pressure on the prosecutors. With outrage following outrage in the media, politicians have been clamouring for quick public hangings. Tom Daschle, the Senate majority leader, put his finger on it in June, when fresh evidence surfaced about WorldCom's misdeeds. “Somebody needs to go to jail,” he wailed.

The Justice Department seems to agree that there may be a problem of slow speed. One of the ideas that its corporate-fraud task-force, a sort of legal think-tank set up to absorb political pressure, has been floating is to bring more less-than-airtight cases before juries, as an antidote to the conservative instincts that white-collar crime encourages among prosecutors.

Prosecutors have some things going for them. The advent of e-mail is one. Most companies keep complete e-mail archives, and if they don't, the library can usually be rebuilt. “Flipping” underlings—accepting their co-operation, plus a guilty plea, to get at the top ranks—is another tactic. Last month, Michael Kopper, who worked in Enron's finance department, pleaded guilty to money laundering and conspiracy to commit wire fraud. The account of his crimes that he gave suggests that the bigger target is Andrew Fastow, Mr Kopper's boss and Enron's former chief financial officer. As the defendants become more important, however, this tactic loses its force: Mussolini gets a deal, as it were, only if he can deliver Hitler. Defendants also have less incentive to co-operate following the introduction of less flexible federal sentencing guidelines in the 1990s.

Subpoenas of witnesses by Congress can hurt the prosecution's case, especially if they give others information about how to build a good defence. Most Enron executives “took the fifth” (the fifth amendment to America's constitution, which protects citizens from self-incrimination) and declined to testify before Congress. But Jeffrey Skilling, a former chief executive, did testify, maintaining his innocence and his faith in the sound judgment of the firm's lawyers and accountants. Others now know Mr Skilling's defence, and can co-ordinate theirs accordingly. Significantly, Congress chose not to subpoena Martha Stewart this week.

Defendants have the best lawyers that a multimillion dollar executive-compensation plan can buy, and several good strategies available. One is to seize the prosecution's ground and to acknowledge the crime, but not the criminal. Their client, goes this line of defence, simply did not know that he or she was doing something wrong. Ms Stewart might have a hard time making this defence: she was once a broker. But Scott Sullivan, WorldCom's former chief financial officer, could make a case along these lines, as he appears to have made no effort to cover up his misclassification of expenses. The surprise is how naked and obvious it all looks.

Mr Comey's young guns are not experienced. Only one in ten of his prosecutors has spent more than five years in his office. Typically, they work like dogs for a few years, then move on to the comforts of private practice. Complicating matters, prosecuting white-collar crime can be a high-profile business, played out in the full glare of television cameras.

The recent dawn arrest of John Rigas, Adelphia's founder, along with two of his sons, raised all sorts of briefly compelling side-issues. Was it a publicity stunt orchestrated to slake the public's thirst for blood? (Answer: No. The arresting officers rang to ask how they should handle the business; Mr Comey told them to treat the Rigases as they would treat anybody else.)

The disarmingly modest Mr Comey appears unruffled by it all. He doesn't seem to care what politicians want or don't want; he doesn't seem to care much about the markets either. What he does care about “is that the bad guys go to jail”.

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Indictments

The charge sheet

Sep 12th 2002 | NEW YORK
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So far, so few

THE wheels of justice turn mighty slow. But they turn. Here is a list of the indictments so far:

• In March, **Arthur Andersen** was indicted by a federal grand jury on charges of obstructing justice.

• In August, Michael Kopper, a senior executive in **Enron**'s finance department, pleaded guilty to money laundering and conspiracy to commit wire fraud.

• Scott Sullivan, a former chief financial officer of **WorldCom**, was indicted in a Manhattan federal court along with Buford Yates, WorldCom's director of general accounting. Mr Sullivan and Mr Yates are each charged with one count of conspiracy to commit securities fraud, one count of securities fraud, and five counts of making false filings with the SEC. Mr Sullivan and the company's former comptroller, David Myers, were arrested on August 1st on securities-fraud and conspiracy charges.

• John Rigas, his sons Michael and Timothy and two business associates were arrested after being indicted by the Justice Department on securities-fraud charges after the bankruptcy of **Adelphia Communications**. Separately, the SEC filed a civil suit against the company, the same five Adelphia executives and a fourth member of the Rigas family.

• On June 4th Dennis Kozlowski, a former chief executive of **Tyco**, was charged with evading sales taxes on six paintings worth about $13.2m. Mr Kozlowski may be about to face more serious criminal charges as well.

• Samuel Waksal, a former chief executive of **ImClone Systems**, was indicted on August 7th on charges of insider trading, bank fraud, forging a signature and destroying records to obstruct a federal investigation.

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Japanese car makers in America

Twenty years down the road

Sep 12th 2002 | TOKYO AND DETROIT
From The Economist print edition

Toyota may be about to join the ranks of America's Big Three car makers

Get article background

TWENTY years ago, the finishing touches were being added to the first Honda cars to roll off the production line at the first Japanese car plant in North America, in Marysville, Ohio. The Japanese manufacturer was there in response to taunts by a Ford chairman, Harold “Red” Poling, that the Japanese should “build cars where they sell them”. In the protectionist mood of the times, the only way Japan's car companies could get round import restrictions was to invest directly in America. Honda, which already had motorcycle production there, was the first, followed over the next four years by Nissan and then Toyota.

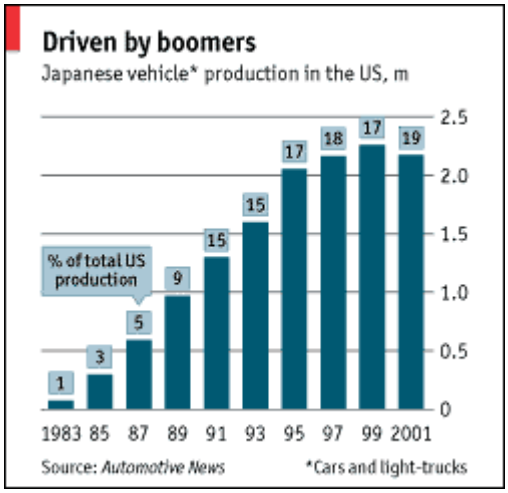
So successful have their cars been since then that Toyota is now poised to replace Chrysler as number three in the American car market, with over two-thirds of its sales manufactured locally. Until American manufacturers rolled out interest-free finance schemes in desperation in September 2001, Toyota had looked like overtaking Chrysler, the weakest of Detroit's Big Three. Yet, only two years earlier, Chrysler's market share had been almost 1.5 times that of Toyota.

The first of millions

“Toyota's market share goes up during downturns,” says Yukitoshi Funo, head of the company's North American operations. Sure enough, its American car sales in the first eight months of this year rose by 4.6% over the same period in 2001, in contrast to declines at Ford and Chrysler. This rate made Toyota's president, Fujio Cho, speculate in New York last week that the company may soon “be in need of another plant” in North America, its fifth, to meet its sales target there of 2m units by 2004.

All three top Japanese manufacturers have ambitious plans to increase their global sales over the next few years, and they see America as the most promising place to grow. It is also where they make well over half their profits, their home market being flat and their European plants still loss-making. Whereas General Motors (GM) makes only about $330 in profit per car, Toyota and Nissan make around $1,000, and Honda over $1,600.

Before the Japanese set up in America, people like Mr Poling thought the secret of their efficient car-making was superhuman labourers working like crazy on the assembly lines back home. So it was a big surprise to complacent American manufacturers when Honda started making cars equally efficiently, using American workers on American soil. Of course, the Japanese were careful to steer well clear of the Detroit area, so avoiding the clutches of the United Auto Workers (UAW) union and its then resistance to modern manufacturing methods. The most efficient car factory in the world is Nissan's plant in Smyrna, Tennessee, where the UAW lost heavily in a recent vote to represent workers.



American consumers soon learned that the real secret of Japanese success was that the manufacturers concentrated on such basics as product quality, inventory control and market research. This is

still working to their advantage. Durability and economy matter when times are hard (and fuel prices are rising), since penny-pinching consumers look for cars that wear well and are frugal. Improved servicing facilities have also boosted sales. A reputation for reliability brings other benefits. Second-hand Toyota Corollas and Honda Accords sell at higher prices than comparable cars made in Detroit. One study showed that GM-marqued cars rolling off its joint plant with Toyota in California were worth less after a few years than identical cars with Toyota badges.

Toyota and Honda have maintained their advantage in other ways. Unlike their American rivals, they have set tight limits on fleet sales to car-rental companies; consequently, their used-car markets are not flooded with car-hire cast-offs. They have also avoided the huge financial incentives that most American car companies now shower on their customers.

Toyota has worked hard at staying close to its dealers. High-level executives visiting from Japan often make a point of calling on dealerships to chat with salesmen. When car sales began falling in 2000, Toyota soon heard from unhappy salesmen that stocks of unsold cars were starting to build up, and it hastily reduced production. American car companies were slower to respond.

Steve Usher, a car-industry analyst at J.P. Morgan in Tokyo, says that another reason why Toyota and Honda have done well is that they have grown up with America's baby-boomers. Japanese cars entered the market in the 1960s and 1970s, when Detroit was still concentrating on building powerful engines rather than raising overall quality. As new entrants, they offered smaller, cheaper, more fuel-efficient vehicles that appealed to the (then) young. As that generation grew older and richer, the Japanese car makers followed them by moving into the luxury end of the market, with brands such as Lexus and Infiniti.

Now that they make light trucks, such as pick-ups and sport-utility vehicles, in America as well, the Japanese have increased to 20% their share of that part of the market (Detroit's last redoubt through the 1990s). Mr Usher thinks they may soon match their one-third share of the saloon-car market.

But the Japanese cannot afford to be complacent. The Indiana factory shared between two smaller Japanese car makers, Isuzu and Subaru, has stopped production because of weak sales. Even Toyota has made mistakes. The T100, initially a big flop, took off only after the company completely overhauled the truck and re-launched it as the popular Tundra; but it is once again under pressure from rivals. European companies are also increasing their North American production: Mercedes is expanding in Alabama, and Volkswagen is considering adding a United States plant to its facilities in Mexico because sales have rocketed since the new Beetle was launched five years ago.

All this means that the Japanese have little room to make mistakes. Being bigger, Toyota can afford to run more risks than Honda. But it is vulnerable to the fact that, although its cars delight and its factories astound, its management remains distinctly old-fashioned and Japanese.

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French bosses

Bon voyage?

Sep 12th 2002
From The Economist print edition

Imitating American ways is no longer the fashion in corporate France

Reuters

In the Bon old days

THIS WEEK, as *The Economist* went to press, the final touches were being put to a rescue package for France Telecom, labouring under debts of *euro*75 billion ($73 billion), six times its market capitalisation. The rescue was due to be announced, with another set of awful results, on September 13th. The most likely solution: a rights issue to raise as much as *euro*15 billion, of which half will come from the government, as 55% owner. Michel Bon, who as the company's boss is most responsible for its travails, is unlikely to keep his job.

Dashing, Anglo-Saxon-style bosses such as Mr Bon have been out of favour in France ever since the decline of Vivendi Universal. Solid, older types with unblemished records are now in; red (ink) has put grey back into fashion. The man who succeeded the flamboyant Jean-Marie Messier as head of Vivendi was Jean-René Fourtou, a former boss of Rhone-Poulenc who is the ultimate in low-key sobriety.

The new conservatism is understandable. It is not only the more adventurous outriders of French business who have come to grief. The two most famous home-grown corporate empires, the retail group of François Pinault and the luxury-goods firm of Bernard Arnault, are struggling with a series of reverses. Even Serge Tchuruk and Pierre Bilger, bosses of the once-solid manufacturing firms Alcatel and Alsthom, respectively, are in difficulty.

In such circumstances it is no wonder that the two favourites to follow Mr Bon at France Telecom are proven local leaders, well-connected to political power. Thierry Breton, chief executive of Thomson Multimedia (the consumer-electronics part of the formerly state-owned Thomson-CSF group), was a local politician in the west of France who made his business reputation running the Futurscope leisure group; he is close to the prime minister, Jean-Pierre Raffarin. Noël Forgeard, chief executive of Airbus, has been a close friend of President Jacques Chirac since his days as industrial adviser to the then prime minister in the second half of the 1980s.

The France Telecom job might be a challenge even for Mr Forgeard, but it would get him out of an awkward spot. He has had a highly successful three years at Airbus, converting it from a consortium into a commercial company, launching its double-decker super-jumbo, and catching up with its rival, Boeing. But he is frustrated.

Airbus is 80% owned by European Aeronautics Defence and Space (EADS), and 20% by BAE Systems. Although jet airliners account for two-thirds of EADS sales and almost all its profits, Mr Forgeard has to report to EADS's bosses. Although he has never said so publicly, it is plain that he would like to take over from the French co-chief executive, Philippe Camus.

One German analyst likens the situation to that of Daimler-Benz when the aggressive Jürgen Schrempp took over in the mid-1990s. The group's luxury-car division, Mercedes-Benz, under the direction of Helmut Werner, was making virtually all its profits at the time. But Mr Schrempp decided the group was not big enough for two abnormal egos. So out went Mr Werner, the architect of the Mercedes revival in the early 1990s.

Airbus's problems are bigger than a mere clash of egos. The old guard at Aerospatiale, the engineers and

managers who built Concorde and launched Airbus, were put out when the French government first privatised the group by selling a big chunk of it to a conglomerate created by Jean-Luc Lagardère, a controversial wheeler-dealer who has outstayed the more recent shooting stars.

Respected for his cool efficiency in reforming Airbus, Mr Forgeard is nevertheless snootily referred to in Toulouse as “one of the Lagardère boys”. Nor has he done much to ingratiate himself with his German bosses: he made Philippe Delmas, who is seen as anti-German because of a book he wrote about world affairs a few years ago, his strategy director. Having done what he was hired to do at Airbus, and frustrated in his bid to rule EADS, no wonder Mr Forgeard's name keeps cropping up as a candidate for top jobs among France's beleaguered businesses.

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KarstadtQuelle

Below par

Sep 12th 2002 | HAMBURG
From The Economist print edition

The boss of the big German retailer is pinning his hopes on golf

SOME say golf is a good walk ruined. Not Wolfgang Urban. The chief executive of KarstadtQuelle, a big German retailer, thinks more Germans will be seduced by the game—and will buy their gear from KarstadtQuelle. It is one of the ways in which he hopes to improve the company's currently miserable margins.

Retailing in Europe's biggest economy, with 82m mostly well-off people, may sound a doddle. It is not. Margins are thin, thanks to fierce price competition, a surfeit of selling-space and weak demand. Retail sales have scarcely budged since the fading of a post-unification surge in the mid-1990s (see chart), and they have fallen every month this year. According to one of Mr Urban's rivals, business has rarely been as bad since the second world war.

At Karstadt, the biggest department-store chain in Europe, sales in the first half of this year were 9.5% lower than in 2001. KarstadtQuelle, its parent, lost *euro*347m ($311m) in the first six months of the year, and its share price has fallen by 50% since the spring. To some extent, these troubles are temporary. Shoppers suspect retailers of using the introduction of the euro in January to mask price increases. Like Karstadt, Thomas Cook, a travel company of which KarstadtQuelle owns half, is in a suffering seasonal business.

KarstadtQuelle has, however, been struggling for more than a few months. Its exposure to Germany, where it makes 90% of its sales, has scarcely helped. Its bigger rival, Metro, where Mr Urban worked for 25 years, also has a troubled German department-store chain, Kaufhof, but it has been partly redeemed by its substantial cash-and-carry business, which operates in 23 countries.

Since becoming chief executive two years ago, Mr Urban has been firing off bright ideas for making money. The plan is to raise margins to 4% by next year: good by German standards, but only half the European norm. The firm is only now exploiting the stack of information—from customers' addresses to their taste in clothes—held by its department stores and two mail-order subsidiaries. The result—store cards, Karstadt-branded credit cards and direct marketing—may be old hat in America or Britain, but in Germany they are still near-novelties.

KarstadtQuelle has also been cutting costs, becoming stingier with its suppliers and shedding 7,000 jobs this year. Yet despite Germany's glut of retail space, it is still reluctant to close any shops. It has 189 department stores, the same as a year ago. Quite a few are in small towns and suburbs, and it owns almost all of them. Indeed, the value of its property portfolio exceeds its market capitalisation, suggesting that the shops could be put to better use. Karstadt is due to reveal plans for its smaller stores in November.

Some could become specialist shops rather than department stores. There is money to be made, Mr Urban believes, from more specialisation. Sport is a prime example. By 2005 KarstadtQuelle, already the market leader, expects to sell *euro*1.2 billion-worth of equipment and clothing, up from *euro*650m last year. The number of big, general sports shops, such as its flagship 6,000 square-metre store in central Hamburg, will rise to 35, from around 30 now. There will also be more shops with a narrower focus,

including a total of 31 devoted to Mr Urban's beloved golf, hitherto an exclusive sport in Germany.

Eventually, KarstadtQuelle might open sports shops abroad. That would reduce its dependence on Germany. Home, though, is the key. The company expects not only to win a bigger share of the German sports-goods market—largely by taking over uncompetitive small firms—but also to fatten its margins, 2.3% last year, to 6% in 2005. However, cheaper competitors, including supermarkets and Tchibo, a coffee seller that also flogs cheap but presentable clothing and household goods, have their eye on the market too. Mr Urban's hope is that quality will count as much as price: in his shops, people will get advice that discounters cannot offer; and he reckons Karstadt's own label, Alex, will command a premium that cheaper rivals will not.

Juicy profits may be on offer in some plush niches, such as golf, assuming the market grows as Mr Urban hopes. In other areas—sports clothing worn as fashion, say—the German market may prove as tough as it has always been. Mr Urban will need luck as well as his experience and skill. It's a bit like golf, really: even well-hit balls can end up in the rough.

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Enel

An ill Wind

Sep 12th 2002 | ROME
From The Economist print edition

Enel's new boss is taking the utility back to its roots

DELIVERING Enel's otherwise routine half-year results on September 12th, Paolo Scaroni, recently appointed chief executive of Europe's biggest listed utility, gave the markets a shock. In his characteristically open style, he announced an entirely new strategy for the diversified group. The man who turned around Pilkington, a troubled British glass maker, made clear that he is junking the grandiose ambitions bequeathed by Franco Tato, his predecessor, and returning to the core energy business: power generation and the distribution of electricity and gas.

Under Mr Tato, Enel had aggressively diversified into activities ranging from water to telecoms and even payroll-processing. By announcing such a sharp break with the recent past, Mr Scaroni has begun the job of restoring confidence in a company that was Italy's biggest privatisation. Since its flotation in November 1999, Enel's shares have fallen heavily. Such a poor performance has disappointed its shareholders, and Enel's tetchiness has annoyed regulators, government ministers and investors alike.

Mr Scaroni inherited a vastly complex structure, with more than 30 managers reporting directly to him. Now there are only four. But the most awkward part of Mr Tato's troubled legacy is Wind, Enel's telecoms arm (of which France Telecom owns 27%). Although well ensconced as Italy's third-biggest mobile operator, Wind is making losses and is heavily in debt. On September 12th, Mr Scaroni said he was writing *euro*1.5 billion ($1.46 billion) off Wind's book value of *euro*9.5 billion. Enel will have to pump *euro*1 billion of cash into the business before it can become financially independent, a benchmark that is at least two years away.

The clear implication is that Wind will be nurtured through the telecoms downturn until it can be sold for a reasonable price. “There are few synergies between telecoms and energy, and these are not allowed by the regulator,” says Mr Scaroni. Add in his stated intention to get out of the water business and a host of other non-core activities, and Enel is destined to re-emerge as a more efficient version of the energy company that it was back in the mid-1990s.

Investors are likely to welcome this refound focus. Mr Scaroni says that his first priority is to instil a culture of shareholder value within the company. Without this, Enel will not attract the big international investors whose support is vital to such a large concern. Hence, for example, its new approach to expanding outside Italy. Mr Scaroni says future deals will be opportunistic and must make immediate financial sense. Logical acquisitions in markets such as Spain, Eastern Europe and neighbouring countries, with which cross-border electricity trade will be possible, will replace the far-flung ventures that were pursued by Mr Tato.

A further important step will be a renewed focus on Enel's domestic energy market. By becoming the low-cost producer and distributor while the market is opening up, Mr Scaroni thinks Enel can hold new entrants at bay. This is also the key to producing the hefty cashflow that will be needed to underpin a generous dividend policy—more than half of Enel's 2001 earnings were paid out to shareholders, not least among them the Italian government, which still has a 68% stake.

A big issue facing Mr Scaroni is whether the government will allow him to run the company as he sees fit. “So far,” he says, “there has not been much difference at all in corporate governance from what I was used to at Pilkington.” That could change, however. Last month the government arbitrarily suspended a tariff rise, at a cost of *euro*40m to Enel. Worse, legislation is in hand that would effectively emasculate Italy's independent energy regulator. By handing control of supposedly liberalising markets back to the politicians, it would run entirely contrary to EU policy.

In the short term, however, such shenanigans could help Enel. By a twisted logic, the more the state interferes, the less foreign investors will be attracted to the Italian market and the less competition Enel will face. The longer-term effects, however, are likely to be invidious. Enel's future competitiveness depends on its ability to become more efficient. For that, Mr Scaroni needs a free hand both for internal restructuring and external negotiations, especially with regulators.

Mr Scaroni says he will leave the company rather than tolerate state meddling. That would have a disastrous effect on Enel's share price and, by ruling out further privatisations, on Italy's public finances. Mr Scaroni might appear vulnerable, but he has some cards. Enel's fortunes stand or fall on how he plays them.

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Endemol

The reality after the show

Sep 12th 2002 | HILVERSUM
From The Economist print edition

How long should the granddad of reality TV stick to the genre?

A YEAR ago, reality television was being dismissed as a short-lived fad. “Big Brother” (a European hit) had disappointed in America; “Survivor” (an American hit) had flopped in Britain. A year on, and the world's small screens this autumn are once again crammed with reality shows. Last week's final of “American Idol”, a talent contest, drew a massive 23m viewers. In Britain this summer, “Big Brother 3” beat each of the previous series.

Yet Endemol, the Dutch-based production company that devised and produces “Big Brother”, “Fear Factor” and a host of other formats, is now wondering how to diversify its wares. No company embodies reality TV more than Endemol. Its rise has been as swift as has the tendency of high-minded critics to pan its output. Just eight years ago, two Dutch TV producers, John de Mol and Joop van den Ende, merged their businesses to create their eponymous Dutch company. Since then, it has hoovered up or launched production companies in 22 countries, to become the producer of almost every format it creates. And on top of all this, its founders sold out at the height of the media boom in 2000 to Telefonica, a Spanish telecoms group, for a staggering *euro*5 billion ($4.8 billion).

Creating over 15,000 hours of programming last year, Endemol is now the most prolific pan-European TV producer. And it has continued to grow through the media downturn. In 2001, its revenues jumped by 63% over the previous year—to *euro*914m. By contrast, over the same period, revenues at FremantleMedia, its nearest rival, which is owned by Bertelsmann's RTL and is behind the format of “American Idol”, grew by just 5%.

Endemol now faces three big strategic questions. The first is whether, as a supplier of content, it also needs a distribution channel. The second is how it can protect its entrepreneurial creative spirit inside a big, unwieldy organisation. And the third is whether it should continue to concentrate on the one-off “event TV” business, in which a show may storm the ratings one summer but then disappear.

In theory, Endemol already has a distribution outlet through its parent company. But Telefonica's TV interests are mainly in Spanish-speaking countries, and its biggest business is telecoms. Synergies between it and Endemol have been minimal. At a time when media conglomerates are going out of fashion, it might seem odd to suggest, as some observers do, that Endemol should free itself from Telefonica and become part of one. Mr de Mol insists that “good product always finds its way to the consumer”, and that he is not actively seeking a broadcast channel. Yet Endemol is keenly aware that, with no favourable treatment from a broadcaster, it is heavily dependent on its hits and its ability to keep creating them.

The very idea of belonging to a traditional media giant would, however, exacerbate the second problem the company is grappling with: the need to balance its Dutch headquarters' desire to keep control with its local operations' wish for creative freedom unburdened by bureaucracy. So far, the company has resolved this conflict by allowing each country to get on with devising ideas for its local market, while the chain-smoking Mr de Mol runs his own creative unit in the Netherlands.

Made up of some 20 people, this team concentrates on ideas for the international market, for both TV and other media. The creative heads meet frequently, as do the business heads of each country, to swap ideas. This flexible structure, along with the company's relatively cosy size—it has only 3,300 employees—makes it fleet-footed in getting ideas from paper on to the small screen.

So far, the formula has succeeded. Endemol's library holds some 500 formats, of which 300 are being produced at any one time. The company has a creative buzz about it that lures young producers. Yet the

qualities that drive Mr de Mol's creativity are not equally suited to the daily grind of improving operating performance and sitting in committee meetings. One of the oddities about Endemol is that it has no chief executive as such. But Mr de Mol is its chairman and chief creative officer, and also, in effect, the boss.

For now, Endemol's unorthodox management structure seems to be working. Yet depending on one-off hits is risky; and making them last is difficult. Which cuts to the third of the big strategic issues facing the company.

Certainly, the temptation is for Endemol to stick with reality TV. It is cheap to make: there are no stars to pay. And it can generate extra revenues from telephone calls, interactive voting and text-messaging—not to mention the records, books and spin-off merchandising. As Tom Barnicoat, chief executive of Endemol UK, says, “off-screen revenues are increasingly critical to the business model for a TV programme.” The formula has also so far proved to be more enduring than many imagined.

Yet the company is keen to balance its reality-TV output with programming that brings in steady revenues, week in, week out. Its Dutch operation already produces lots of soaps and other cheap forms of popular drama, such as police and hospital series, which have more lasting franchises. As they grow, the overseas businesses are looking to do the same.

For now, however, reality TV is serving Endemol well. The company seems to have an inexhaustible supply of variations on a theme, ranging from the merely voyeuristic to the grotesque. The world can thank it for “Big Diet”, a format in which ten fat candidates move into a house and race to get thin. Or “Exhausted”, devised by its American arm, in which contestants are deprived of sleep and then made to perform tasks. Mr de Mol is unapologetic. “The only criticism I agree with is that they are voyeuristic; but that's just normal human behaviour.”

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Luxury submarines

One-downmanship

Sep 12th 2002 | WASHINGTON, DC
From The Economist print edition

Now you really can live in a yellow submarine

LANCE BASS, boy singer with the group 'N Sync, must be feeling down. His bid to fly to the International Space Station fell through when he was unable to raise enough cash for the return fare. But he might raise his spirits by lowering his sights. For half the price of going up he could go down, to a world nearly as unexplored as space. He could buy a personal luxury submarine from one of two American companies, Olympic Submarine Technologies and US Submarines, now marketing it as the latest “ultimate accessory”. Microsoft's co-founder, Paul Allen, is said to be among the first buyers.

On offer in a range of sizes, diesel-electric luxury submarines can be fitted out like top-of-the-range business jets and hoisted on and off your personal cruise-ship. Or, indeed, they could be a personal cruise-ship, just like the ocean-going bimbo carrier belonging to your neighbour in the harbour except that it can also cruise below the waves. How about that for one-downmanship?

“We're bringing super-yacht interior amenities together with technologies from military, commercial and tourist submarines to produce true luxury vessels,” says Jim Carnahan, Olympic Submarine Technologies' director of marketing. Olympic is offering the Olympic 40, a 40-footer capable of cruising at a depth of 1,200 feet for eight hours. The interior includes an elegant passenger compartment, bathrooms, a galley and large windows through which to view the wonders of the deep. Mr Carnahan believes that the “surface is just being scratched” in terms of the technology they could incorporate.

L. Bruce Jones, co-founder of US Submarines, agrees. His company plans a range of luxury models—from 65-foot diesel-electric ones with passenger space similar to a medium-sized executive jet, for $4.5m, to 118-foot varieties with five state rooms and a transatlantic range, for just $20m. Both firms stress the advantages of submarines: a superior ride in rough seas (below the surface), and a consistent atmosphere. “Regardless of depth you're in shirt-sleeved, air-conditioned comfort,” notes Mr Jones.

Both firms are going after the same group of customers—people attracted to luxury yachts. Mr Jones believes the potential market could be as big as $100m a year. “Most people haven't viewed any portion of the sea floor. Cruising along the continental shelf there's no telling what you might encounter.” Not, it seems, rock-bottom prices.

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Face Value

Cooking Martha's goose

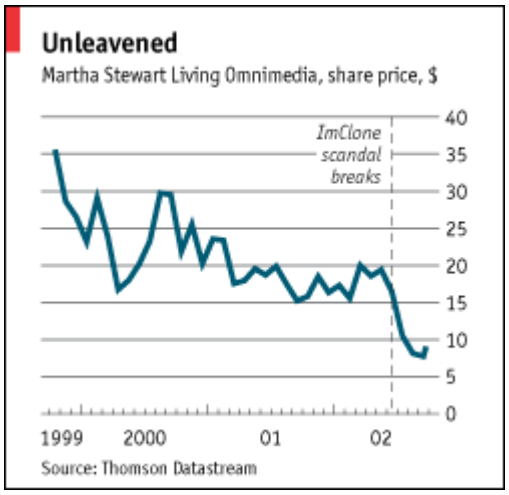
Sep 12th 2002
From The Economist print edition

The Martha Stewart scandal may cripple a media empire built on an image of perfection

THE heat is turned up, and the ingredients are blending into America's juiciest financial scandal. In the pot is Martha Stewart, the homemaking queen who has baked, decorated and, say critics, clawed her way to star status and huge personal wealth. Ms Stewart, 61, now faces the double jeopardy of a possible jail term and of being ousted as boss of her closely controlled media empire, Martha Stewart Living Omnimedia.

She is under investigation for possible insider dealing, when she sold her shares in ImClone Systems the day before the biotech company announced that its main drug had failed to satisfy the regulators. Perhaps equally serious, she is also being investigated for obstructing justice by lying to prosecutors about the details of her share sale.

Although she has so far escaped being charged, on September 10th her case was passed to the Justice Department at the urging of a congressional committee before which she had refused to testify. ImClone's former boss, Sam Waksal, Ms Stewart's friend and her daughter's ex-boyfriend, has already been arrested on charges of insider dealing. Omnimedia, worth $2 billion at its peak, has seen its share price fall by 60% since the scandal first emerged in June (see chart). Last week, the company was forced into an official denial that it was seeking to replace Ms Stewart, its chairman, chief executive and controlling shareholder.



Pressed pansies

Martha Stewart's image is, in short, in tatters. Jokes about how to sponge-paint a cell wall abound. The media lambasted a priceless moment on her weekly CBS breakfast spot, now on hold, when, asked about the scandal, she chopped savagely into a cabbage, grating: “I want to focus on my salad”. Meanwhile a bestselling biography published this spring paints her as a “Queen of Mean” control freak.

If the allegation that Ms Stewart illegally avoided a potential loss of $270,000 sounds trivial next to the breathtaking frauds at Enron and WorldCom, this underestimates the enduring fascination that she holds for Americans. Martha Kostyra, a Polish-American from New Jersey, spent her teens sewing her own dresses and cooking for a family whose poverty and abusiveness she later tried to hide. Following a stint as a model, she became a stockbroker at a firm that, prophetically, tanked after a share-dealing scam.

It was the act of restoring a wrecked house in Connecticut with her ex-husband Andy that steered Ms Stewart, a workaholic fuelled by ambition and chronic insomnia, towards homemaking as a career. Her gourmet-food shop became a catering business and in 1982 she published her first book, the best-selling “Entertaining”. Her business instincts, even then, were formidable. In 1987, she persuaded Kmart to sell and market her products, at a huge cost to the now-bankrupt nationwide retailer.

The effect was to turn her into a household name. She talked Time Warner into funding “Martha Stewart

Living” magazine, which became a hugely successful title. When Time Warner dismissed her plan to cross-sell her publishing, TV, merchandising and Web interests, she bought back her brand rights and, in 1999, took the entity public just as sales were soaring. Turnover hit $296m in 2001.

Half of America is in awe of her success and determination. But the other half delights in debunking her carefully constructed mythology, pointing to the tortured personality that lies behind it. Stories abound of how she has exploited friends, belittled her ex-husband and once tried to back over a gardener in her pick-up truck. One store in California is trading equally well in “Save Martha” T-shirts and in ones with her smiling face behind bars.

That is what makes the ImClone allegations so dangerous to the Martha Stewart brand. While Ms Stewart's public image has always had an edge—more dominatrix of domesticity than goddess of goodness—its essence is her perfection. Capitalising on the chronic insecurity of Americans in matters of taste, she branded herself the ultimate authority on perfect living, be it making coasters from pressed pansies or whipping up dinner for 20 in half an hour. Now her image is looking a sham and Ms Stewart appears just as fallible, greedy and, above all, naive, as her public. For a government seeking a symbol of corporate greed, Ms Stewart, a well-known contributor to the Democrats, is, well, perfect.

The sullied reputation of its founder is sure to have serious consequences for Omnimedia. Already the company has given warning that third-quarter profits will be half Wall Street's forecasts and that advertisers are taking a “wait-and-see” attitude to future bookings. The company's president, Sharon Patrick, plans to promote “new faces” to take the spotlight off Ms Stewart. But as the embodiment of an abstract marketing message, Martha is surely irreplaceable. Without free advertising from her ubiquitous TV shows, a syndicated column in 230 newspapers, an “Ask Martha” radio show on 330 stations and a magazine with 2.4m readers, publicity costs would wipe out profits.

The scandal comes at an inauspicious time for the company. Its publishing arm, 60% of its sales, is maturing. Television (9%) is suffering declining ratings and the Internet operation (10%) is making heavy losses. Most worrying, up to 90% of the group's profits come from merchandising, largely via Kmart, which has been in bankruptcy since January. The retailer is likely to shut a third of its stores and may renegotiate its licence with Omnimedia.

Many companies are closely intertwined with their founders. Some can survive personal scandal. But Martha Stewart has a unique symbiosis with her company, its brands and her products. With a tainted Ms Stewart on board, it is hard to see how Omnimedia can recover. But without her, it is not clear that the company has any future at all.

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The world economy

Dial D for deflation

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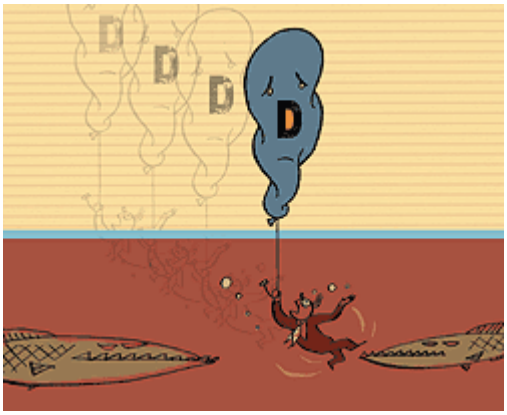
From The Economist print edition



The biggest risk facing the world economy may be deflation, not a double-dip

THE global economy continues to sputter. Yet most economists and policymakers do not expect a double-dip recession in America or elsewhere. This week Horst Köhler, the IMF's managing director, was the latest to play down the risk of recession. Yet this misses a crucial point: even if economies continue to expand over the next year, growth may not be strong enough to prevent the onset of deflation—falling prices—in several countries.

America's economy continues to give out mixed signals. Investment remains weak, after dropping for seven consecutive quarters—the longest unbroken fall since the second world war. But optimists pin their hopes on the American consumer, who continues to spend (and borrow) with reckless abandon. For how long? At first sight the fall in America's unemployment rate from 5.9% in July to 5.7% in August seems good news. But the jobless rate, which is based on household surveys, is notoriously volatile. The monthly payroll figures, which are more reliable, show that America's labour market remains weak. Private-sector employment was virtually flat in July and August. This weakness, along with lower share prices, has already dented consumer confidence (see article).

After four consecutive quarters of decline, Japan's GDP rose faster than America's in the second quarter—by 2.6% at an annual rate. But its economy remains fragile. Retail sales fell by 4.8% in the year to July, and deflation continues unabated. Average wages fell by 5.6% over the same period, as company bonuses slumped.

With Japan still sickly and America experiencing a wobbly recovery, one might hope that Europe would ride to the rescue. Dream on. The euro area has also disappointed this year. Not only did GDP grow at an annual rate of only 1.4% in the second quarter, but much of that came from net exports; domestic demand was feeble. The prospects for the third quarter look grimmer. Germany's economy may now be contracting again: its IFO business-sentiment index has fallen for three consecutive months. In the euro area, demand is being squeezed by a stronger currency, as well as by the fall in share prices. Many forecasters have revised their predictions for growth in 2002, to below 1%.

A double-dip recession in America—or indeed in Germany—is certainly possible. But a more likely outcome is that America could suffer a few years of below-trend growth as the economy's imbalances, such as excessive debt and insufficient saving, are put right. A couple of years of modest growth, so long as it remains positive, may not sound so bad. But this misunderstands the relationship between inflation and the output gap (the difference between actual and potential GDP).

Letting off air

Contrary to popular opinion, inflation does not always rise when the economy expands, nor fall when it shrinks. Instead, the future path of inflation depends largely on the size of the output gap. If the level of GDP is below potential (meaning there is spare capacity), inflation can fall and keep falling, even if the economy is growing briskly, until GDP rises back to potential and the negative output gap is eliminated. But if America's growth remains below potential (3-3.5%, according to most economists), the output gap will actually widen, putting even more downward pressure on prices.

After the 1990-91 recession, America still had a large negative output gap until 1993; and inflation fell from 5% to 2.5%. Today, America's rate of consumer-price inflation is only 1.5%, and its GDP deflator is rising at a rate of only 1%. A similar decline to that experienced in 1990-91 would take it into deflationary territory. Indeed, according to Dresdner Kleinwort Wasserstein, corporate America is already living with deflation. The implicit price deflator of the non-financial business sector (services as well as manufacturing) fell by 0.6% in the year to the second quarter—the first fall since the second world war (see chart).

The risk of deflation in the euro area as a whole remains much slimmer; inflation is still over 2%. But Germany's inflation rate is only 1% and it could well drop over the next year, as weaker growth causes its output gap to widen by more than elsewhere. Even if the European Central Bank's (ECB's) monetary policy is appropriate for the euro area as a whole, it is too tight for Germany alone.

As a result, there is a risk that, before the end of 2003, the rich world's three biggest economies—America's, Japan's and Germany's—could all have negative inflation rates. A sharp jump in oil prices as a result of America invading Iraq could, of course, push up headline inflation. But the longer-term impact of higher oil prices would be deflationary, not inflationary. Higher oil prices operate like a tax that depresses growth, so their medium-term impact would be to heighten the deflation risk.

DeAnne Julius, a former member of the Bank of England's monetary policy committee, argued in a recent speech that there is a one-in-three risk of a significant deflationary period in the main economies between now and 2005. But many of today's central bankers, brought up to believe that their job is to fight inflation, seem to be underplaying the risk.

Deflation is much more harmful than inflation. Falling prices encourage consumers to postpone spending in the expectation of cheaper goods tomorrow; they also make it impossible to deliver negative real interest rates if these are needed to drag an economy out of recession. Most dangerous of all is a cocktail of deflation and debt. Deflation pushes up the real burden of debt, while the value of assets linked to that debt, such as house prices, may have to fall even more sharply in nominal terms to return to a fair level. This has already caused severe balance-sheet problems in Japan, and now America and Germany may be at risk: in both countries debts have surged to record levels.

Central bankers in America and Europe—but not in Japan—still have room to cut interest rates. However, the ECB held interest rates unchanged at 3.25% on September 12th. So long as inflation remains above the ECB's target of “less than 2%”, the bank will be in no rush to ease policy. The Fed is also widely expected to keep rates steady at its policy meeting on September 24th. Why wait, when the risks are so lop-sided? Once deflation sets in, monetary policy can do little to revive an economy. If economies perk up and a rate cut turns out to have been unnecessary, it can be reversed: with ample excess capacity, the risk of inflation taking off is low.

Many central bankers do not seem to grasp that this economic cycle is different from its predecessors. The recession was caused not, as before, by inflation taking off, but by the bursting of an asset-price bubble. American economists blame Japan's deflation on the incompetence of its policymakers. There is some truth in this, but the awkward fact is that post-bubble economies tend to be deflation-prone.

Even with interest rates at zero, Japan might have escaped deflation two years ago, when the American economy was strong, by devaluing the yen. But the world economy cannot pull off that trick. That is why

central banks in America and Europe need to heed the danger now. “Deflation is like quicksand,” says Dylan Grice of Dresdner Kleinwort Wasserstein; “easy to get stuck in, more difficult to escape.”

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Consumer confidence

Mood swings and downswings

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Can consumer confidence predict the cycle?

“CONFIDENCE obviously matters,” Robert Solow, a Nobel laureate in economics, has said, “and it is just as obviously unmeasurable. So it can explain anything.” The University of Michigan is willing to cross swords with the Nobel prize-winner on at least part of that claim. It is confident it can measure American consumer confidence. Twice a month it asks 5,000 consumers how they feel about their current finances and future prospects (the Conference Board, a New York-based business club, does a similar survey). Since June, Michigan's index has fallen from 92.4 to 87.6. This week, the first September reading will be closely watched for further signs that American consumers are losing their nerve.

But if some believe confidence can be measured, others doubt it can explain anything. Carl Steidtmann, Deloitte's chief economist, argues that the media, and many economists, give too much weight to consumer confidence. “Consumers don't base their spending behaviour on their hopes and fears,” he says. “They base it on their cashflow.” With taxes cut, incomes growing, and jobs stable, consumers have money to spend—and spend it they have, boosting retail-sales volumes by 1.1% in July. Consumers may feel glum, Mr Steidtmann accepts, but what counts is how they act. If they keep buying, it doesn't matter whether they see the shopping trolley as half-full or half-empty.

The University of Michigan's Philip Howrey has scrutinised the predictive power of consumer sentiment more carefully. His findings cut both ways. As Mr Steidtmann suggests, once October's figures for personal income are known, consumer confidence will have nothing more to say about fourth-quarter spending. But those figures will not be out until the end of November. October's confidence reading is available a month earlier. Consumer sentiment is news, Mr Howrey finds, but only until the income figures are released.

Consumer confidence also yields clues about the chances of a recession. It is a better leading indicator of downturns than the stockmarket, and, when combined with stock prices, it says more. In the fourth quarter of 2000, for example, even as Al Gore touted the economy's strength in his election campaign, a forecast based on consumer sentiment and share prices suggested a rising probability of a 2001 recession. More ominously, in the summer of 1981, with the economy growing at over 4% and recession seemingly over, falling confidence gave a strong hint of the double dip to come.

Mr Steidtmann discounts such hints: “We cannot think ourselves into or out of a recession,” he insists. Animal spirits, as Keynes argued long ago, may guide the actions of investors, but consumers, the evidence suggests, are still ruled by their wallets.

Popular capitalism may be changing that. Thanks to credit cards, home-equity loans and mutual funds, what consumers have in their wallets depends partly on their willingness to gear up, play the stockmarket, and bet on house-price booms. When their animal spirits flag, consumers may hoard money rather than borrow more. If so, their prudence may bring on the very recession they hoped to cushion themselves against. For Mr Steidtmann, hopes and fears have no economic meaning. But as Keynes's biographer, Robert Skidelsky, has said, “fear of the future can take its revenge on the hopes of the present.”

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Reinsurance risks

Disaster and its shadow

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Reinsurers are rethinking their risks, and trying to quantify them better

EPA

It's happening too often

CATASTROPHES have been a hard school for reinsurers. After each disaster, reinsurance companies have tried to improve the way they manage their risks. Hurricane Andrew, which wrought havoc in Florida in 1992, the Northridge earthquake that shook California in 1994, and the windstorms that blew across Europe in 1999 all helped with the learning curve.

Yet the past year's man-made and natural mega-catastrophes have made many reinsurers question why they are in the business at all. The terrorist attacks in America caused the biggest reinsured losses ever. An explosion at a chemical plant in Toulouse last September was one of the costliest industrial accidents in history. And recent floods in Europe will cost reinsurers billions of dollars.

Despite hefty increases in reinsurance premiums when contracts were renewed at the beginning of the year, the industry is not well. In its annual report on reinsurance, released on September 9th, Moody's Investors Service says the outlook for the industry is negative in the near term, citing unprecedented catastrophe losses, poor investment returns and the consequences of the previous low level of premiums. The Financial Stability Forum last week criticised the opaqueness of reinsurance, worrying about the effect of undisclosed problems in the industry on the world financial system.

Moody's lowered the credit ratings of four reinsurers eight months ago. But Patrick Ryan, chairman of Aon, a reinsurance broker, gave warning this week against reinsurers retreating from the market at a time when demand is increasing. Cigna, CNA, Generali, Gerling and Royal & Sun Alliance (all companies that write primary insurance and reinsurance) have partly or entirely withdrawn from reinsurance. Others have either sold or spun off their non-life business, or have plans to do so.

The reinsurers and primary insurers that are still in the catastrophe game have increased their premiums, but they have been excluding more risks and tightening terms and conditions on contracts. Since September 11th 2001, about $24 billion of new capital has gone into reinsurance, a third of it in Bermuda. But that is still not enough.

Although the industry is going through a rough patch commercially, reinsurers are attempting to quantify more carefully their exposure to catastrophe risk. That increasingly means the use of computer programs to model probabilities.

Applied Insurance Research (AIR), Eqecat and Risk Management Solutions (RMS) are the three biggest risk modellers. Their quantitative measures of risk saw more demand after Hurricane Andrew ten years ago. “Before Andrew everyone assumed the largest probable hurricane loss was $7 billion,” says Karen Clark, AIR's chief executive. AIR had estimated that hurricanes could cause losses of as much as $30 billion. Within hours of Andrew striking, AIR put the estimated losses at $13 billion, only a bit lower than the final bill.

Risk models for natural catastrophes try to capture two things: severity (how hard a catastrophe might hit) and frequency (how often it might happen). Severity is calculated by gathering earth-science data—wind-patterns to assess the strength of a hurricane, shifts in tectonic plates to determine the strength of an earthquake. These data are overlaid with estimates of exposure: for example, the number of buildings

in an area that are vulnerable and what it would cost to rebuild them. “These models are very good on severity, but frequency is much harder,” says Todd Bault at Sanford Bernstein, an investment-research firm. Historical data on catastrophic events are understandably rare. Risk models can only guess at the probability of a strike in a particular place. It is possible, for instance, to say that there is a 60% chance of a major earthquake in Istanbul in the next 30 years, says Howard Kunreuther at the Wharton School at the University of Pennsylvania. But that does not narrow down the year.

Since September 11th, there has been a new focus on risk-modelling terrorist attacks. Almost all reinsurers at present refuse to write terrorism business. Some would, however, re-enter the market if they understood the probabilities better.

AIR released its risk model for terrorism last week and RMS will follow on September 18th. Both companies worked with counter-terrorism experts from the FBI, the CIA and the Rand Corporation, as well as with experts on weapons systems and asymmetric warfare. They catalogued landmarks to identify potential targets for attacks (AIR found more than 300,000). They are evaluating terrorists' capabilities by, for instance, studying their weapons, and then estimating the cost of a terrorist attack. RMS is also using game theory to model the terrorist mindset. “This is much more challenging than natural-catastrophe models,” admits Hemant Shah, chief executive of RMS. As with modelling natural disasters, it is easier to assess severity than frequency.

Many reinsurers are sceptical about modelling terrorist risk. Most prefer old-fashioned prudence, which at present dissuades them from insuring it at all. Whatever the usefulness of the models, the debate may make reinsurers' attitude to catastrophe risk less reactive. RMS is encouraging its clients to take a “holistic” view of their catastrophe risk, rather than writing business too cheaply in the good times, then recoiling irrationally after each unexpected disaster. If reinsurers were mindful of the total catastrophe risk in their portfolio, says Mr Shah, they would be much more prudent.

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Citigroup

Passing the buck

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Sandy Weill says Citi should have higher standards

“CERTAIN of our activities do not reflect the way we believe business should be done,” said Citigroup's chairman, Sandy Weill, this week. To underline his point, and divert attention from himself as prime architect of Citigroup's complex business edifice, he moved another man sideways: Michael Carpenter, head of Citi's investment bank, Salomon Smith Barney, which is under investigation for dubious business practices.

Mr Weill did something similar in June, displacing Victor Menezes, head of emerging markets, after Citigroup had been caught with a big exposure to a collapsing Argentina. In August, when Citi's former enthusiasm for telecoms shares became an embarrassment, the erstwhile prized analyst behind it, Jack Grubman, found it wise to resign. The bank is still under fire for structured-finance transactions done for Enron, bond underwriting for WorldCom and the curious methodology it used to allocate initial public offerings. It is also negotiating with the Federal Trade Commission to settle charges of predatory lending to retail customers.

Given the heightened risks of prosecution and litigation that threaten Citigroup, Mr Weill's choice of Charles Prince, the group's former top lawyer, to run the investment bank may seem appropriate. But it is more like damage limitation than a drive for higher returns. Expect more changes as performance in other bits of Citigroup's business fails to show Mr Weill in a good light.

Mr Prince's appointment was accompanied by the trumpeting of a new, more virtuous business model. Citi will resolve the conflicts between research and investment banking, file its financial reports sooner, allocate public offerings more fairly, project gains in pension funds more conservatively, treat stock options as an expense, and insist that structured transactions be more clearly disclosed. “No platitude is being left unsaid,” commented Kathy Shanley of Gimme Credit, a research boutique. A new “best practices committee”, reporting directly to Mr Weill, will ensure that Citi follows the “industry's highest standards”. What, it is fair to ask, were the standards before?

Mr Weill has been careful to blame any problems on industry practices and to insist that no laws were broken. But the legal-proceedings section of the company's second-quarter report to the Securities and Exchange Commission makes sobering reading. On June 30th, eight separate suits were pending over Global Crossing, and 15 over WorldCom. That was before Citi executives were grilled in congressional hearings, bringing out more details of Citi's business practices. These issues may have to be resolved before Citi wins regulatory approval for its $6 billion acquisition of Golden State Bancorp, a large California thrift that would expand the group's retail-banking business to the West Coast.

Citi's shares are trading at 40% below their latest high. That is despite the flurry of recent announcements, and results which were the envy of Wall Street. In the first six months of the year Citi made almost $9 billion in profits, shrugging off poor business conditions in America and assorted disasters in Latin America. Return on equity was over 20%. The problem is the future.

Citi faces tighter regulation and the risk that, in a stricter environment, the most lucrative and complex transactions may no longer be feasible, says David Ellison, manager of the FBR Financial Services Fund, a mutual fund. Citi's investment-banking clients, under close market scrutiny, will have to provide so much disclosure that the complexity will not be worthwhile. No outsider can be sure how much of Citi's profits came from such work. The market fears that “best practices” will translate into lower returns and higher risk. Changing that view will take more than a mere management reshuffle.

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Tokyo commercial property

A fading star

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Dazzling office buildings are launched into a dying market

RECESSION? What recession? So visitors must wonder as they take in Tokyo's bustling streets and its skyline, dotted with large cranes. Tokyo has enjoyed a building boom over the past couple of years: office starts tripled between 1998 and 2000. Huge new office complexes are being built in prime central locations. The biggest, due to be completed next spring, will provide more than 2m square metres of new office space (smaller projects are expected to add another 3m square metres).

But demand is falling. There are worries that excess commercial property, dubbed the “2003 office problem”, will soon stop Tokyo's mini construction boom and bring down the high occupation rates seen since 2000.

The latest buildings are still luring tenants with their high-tech systems, spaciousness and fashionable designs. One of the swankiest, the new Marunouchi Building—built by Mitsubishi Estate, Japan's second-largest property company—opened for business on September 6th and is already fully occupied. The 37-floor tower, located in the heart of Tokyo's business district, has 160,000 square metres of floor space, housing 140 shops and restaurants and 50 businesses, such as Mitsubishi Securities, its biggest tenant, NTT DoCoMo, Bloomberg and PricewaterhouseCoopers. With other big names moving into three big new developments in Roppongi, Shinagawa and Shiodome next spring, older office buildings are starting to seem unwanted.

That is reversing a trend since the early 1990s when, according to Ikoma Data Service System, a real-estate research centre, vacancy rates in Tokyo started to fall, in fits and starts, from highs of about 9% to 3.6% by early 2001. For big, new buildings in prime locations the rate fell to less than 1%, because of fresh demand from foreign companies and Internet start-ups. Rents in the best bits of Tokyo even went up.

But the end of the Internet bubble and the stockmarket downturn have led foreign investment banks to scale down their operations, or even to move out of Japan altogether. Vacancy rates, 5.1% at the end of June, could rise to 7% next year, predicts Toshihiko Okino, a construction and property analyst at UBS Warburg, an investment bank. Similarly, rents are coming down. Mr Okino reckons they have fallen by about 15% since 2000. Big developments completed last year with pricey rental targets have had to lower rates to fill their space.

That in turn will hit Tokyo's property prices, which have for the past few years fallen less sharply than in other regions. This is because Japan has adopted an “income approach”, a method used in other rich-world countries, which uses rent levels to calculate land prices. Still, Tokyo is unlikely to fare as badly as other areas, which are suffering horribly. For example, vacancy rates are as high as 20% in neighbouring Chiba, and even in Osaka, the second-largest city, they are in double digits. Better transport—a new *shinkansen* (bullet train) stop will open next year in Shinagawa, the site of Tokyo's biggest new development—and struggling regional economies are leading many companies to move even some of their back-office functions back to the capital.

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Terrorist finance

Moving target

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From The Economist print edition

Money launderers keep a few steps ahead of academe

HAD a money launderer or a terrorist financier attended the International Symposium on Economic Crime in Cambridge this week, he might have felt reassured. Despite the symposium's gung-ho title—"Putting the Crooks out of Business!"—the hundred or so police officers, academics, lawyers, regulators and politicians who gather for this meeting every year admit that their quarry is always several steps ahead of them. There is continuing disunity in the international effort against money laundering and terrorist financing. In the corridors, officials complained that many countries still either refuse or prevaricate when asked to co-operate with their investigations.

In previous years, the symposium has tended to tackle issues such as counterfeiting, smuggling and piracy on the high seas. Now its main subject is terrorist financing. Much progress has been made in the past year, said David Aufhauser, general counsel to the American Treasury and head of a joint agency task-force on terrorist finance. Al-Qaeda is being forced into "neanderthal" conduits such as gold bars and sacks of cash, he said, although it is still raising money from the same old sources—such as drug trafficking and charities.

Disappointingly, given that most of the money which financed the September 11th attacks came through the United Arab Emirates, there was only one speaker from the Arab world, a Kuwaiti. Middle Eastern regulators would have been particularly interested in one of the symposium's subjects: what western countries will do about *hawala*, a trust-based method of moving money that is used by terrorists as well as by expatriate workers in the Gulf and elsewhere. The Treasury's specialist anti-money-laundering body, FinCEN, is trying to defend *hawala,* saying that it should be regulated but not pushed underground. It fears, however, that Congress will simply make it illegal.

There was criticism too of America's war on terrorist finance. Countries must deal with terrorism at the political level: "no other method works," said G. L. Pereis, a Sri Lankan minister, who will lead his country's talks with the Tamil Tigers next week. America's anti-terrorist zeal may hurt the innocent, some argued. A lawyer, Wilmer Parker, described the plight of his client, a chicken-plucking firm in north Georgia. After an investigation by America's customs service for connections between its president and an Islamic charity, the company is facing bankruptcy, even though no charges have been brought. Its banks, wary of being accused of financing terrorism, may cut its credit lines. Just because some terrorists use clean money from legitimate businesses, says Mr Parker, the government should not trample on people's constitutional rights.

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Congo's currency

Too many notes

Sep 12th 2002 | BUKAVU, EASTERN CONGO
From The Economist print edition

Exchange-rate arbitrage favours the brave

Get article background

Reuters

Fresh notes—with the same serial number

FOUR years ago, a new government renamed the country (it used to be Zaire) and launched a new currency, the Congolese franc. The dictator, Laurent Kabila, promised a fresh start after the hyperinflationary binge of his predecessor, Mobutu Sese Seko. Perhaps he should not have given 30 different ministries licences to print money. By 2000, inflation was 511%—lower than under Mobutu, but still dire.

Then, last year, Mr Kabila was assassinated. His son and successor, Joseph, stopped the presses. This year, inflation is expected to be about 14%. Mr Kabila junior also ended a rigged official exchange-rate, enforced with the death penalty, that had allowed his father's cronies (but nobody else) to sell francs for greenbacks cheaply and change them back at a 400% mark-up. Things are now better, but still far from normal. Congo is huge (more than six times the size of Germany), divided by a four-year-old war, and has virtually no roads. Rebel-held eastern Congo is cut off from the central bank's printing presses in the capital, Kinshasa, so the notes in circulation, which were once red, pink and orange, are now dirty brown.

Exchange rates vary in different parts of the country. In Kinshasa, the franc trades at about 325 to the dollar; in the east, it is 240; in the area of northern Congo controlled by Jean-Pierre Bemba, a warlord, the rate is 220. Shopkeepers are suspicious of all banknotes anyway, because a previous government once counterfeited its own currency (the official printers printed two or more copies for each serial number, and various cronies kept the duplicates). Traders in the east will accept neither the pink 50-franc note, featuring a humble mud-hut, nor the blue 100-franc note, with its rather grander hydropower station. In the north, all denominations above 20 francs were barred by Mr Bemba, the warlord, until he made peace with the government this year and declared all Congolese notes legal tender in his fief. That includes a relic of the Mobutu era, the new zaire, a gorgeous pink currency, which still circulates in the north at a couple of million to the dollar.

Regional differences in exchange rates are an opportunity for the brave. Army officers buy bundles of francs cheaply in western Congo, smuggle them across the front line, and sell them at a profit. Even UN officials have been implicated: last year, UN ceasefire-monitors were accused of flying bales of cash from Kinshasa to Kisangani, an eastern town, in their taxpayer-financed planes. In general, when the fighting ebbs, as it did after a ceasefire last year, exchange rates tend to converge.

Yet even in Kinshasa the rate remains volatile. One evening last year the franc nearly doubled in value, because a brigade of Zimbabwean soldiers, who were in town to prop up the Congolese government, tried to exchange their dollar pay-packets all at the same time. A peace deal in July between Congo and Rwanda raised hopes of a bit more monetary stability. But Rwanda's troops have not yet quit Congo, and a recent rumour that they plan to make the Rwandan franc legal tender in eastern Congo suggests that they may remain there for quite a while. If so, the chaos will continue.

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Economics focus

The dollar and the deficit

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Why the dollar still rules the world—and why the world should be grateful

THE dollar is looking vulnerable. It is propped up not by the strength of America's exports, but by vast imports of capital. America, a country already rich in capital, has to borrow from abroad almost $2 billion net every working day to cover a current-account deficit forecast to reach almost $500 billion this year.

To most economists, this deficit represents an unsustainable drain on world savings. If the capital inflows were to dry up, some reckon that the dollar could lose a quarter of its value. Only Paul O'Neill, America's treasury secretary, appears unruffled. The current-account deficit, he declares, is a “meaningless concept”, which he talks about only because others insist on doing so.

The dollar is not just a matter for America, because the dollar is not just America's currency. Over half of all dollar bills in circulation are held outside America's borders, and almost half of America's Treasury bonds are held as reserves by foreign central banks. The euro cannot yet rival this global reach. International financiers borrow and lend in dollars, and international traders use dollars, even if Americans are at neither end of the deal. No asset since gold has enjoyed such widespread acceptance as a medium of exchange and store of value. In fact, some economists, such as Paul Davidson of the University of Tennessee and Ronald McKinnon of Stanford University, take the argument a step further (see references at end). They argue that the world is on a de facto dollar standard, akin to the 19th-century gold standard.

For roughly a century up to 1914, the world's main currencies were pegged to gold. You could buy an ounce for about four pounds or twenty dollars. The contemporary “dollar standard” is a looser affair. In principle, the world's currencies float in value against each other, but in reality few float freely. Countries fear losing competitiveness on world markets if their currency rises too much against the greenback; they fear inflation if it falls too far. As long as American prices remain stable, the dollar therefore provides an anchor for world currencies and prices, ensuring that they do not become completely unmoored.

In the days of the gold standard, the volume of money and credit in circulation was tied to the amount of gold in a country's vaults. Economies laboured under the “tyranny” of the gold regime, booming when gold was abundant, deflating when it was scarce. The dollar standard is a more liberal system. Central banks retain the right to expand the volume of domestic credit to keep pace with the growth of the home economy.

Eventually, however, growth in the world's economies translates into a growing demand for dollar assets. The more money central banks print, the more dollars they like to hold in reserve to underpin their currency. The more business is done across borders, the more dollars traders need to cover their transactions. If the greenback is the new gold, Alan Greenspan, the Federal Reserve chairman, is the world's alchemist, responsible for concocting enough liquidity to keep world trade bubbling along nicely.

But America can play this role only if it is happy to allow foreigners to build up a huge mass of claims on its assets—and if foreigners are happy to go along. Some economists watch with consternation as the rest of the world's claims on America outstrip America's claims on the rest of the world. As they point out, even a dollar bill is an American liability, a promise of ultimate payment by the US Treasury. Can America keep making these promises to foreigners, without eventually emptying them of value?

According to Mr Davidson, the world cannot risk America stopping. America's external deficit means an extra $500 billion is going into circulation in the world economy each year. If America reined in its current account, international commerce would suffer a liquidity crunch, as it did periodically under the

gold standard. Hence America's deficit is neither a “meaningless concept” nor a lamentable drain on world savings. It is an indispensable fount of liquidity for world trade.

Spigot by nature

But is the deficit sustainable? Many of America's creditors, Mr McKinnon argues, have a stake in preserving the dollar standard, whatever the euro's potential charms. In particular, a large share of America's more liquid assets are held by foreign central banks, particularly in Asia, which dare not offload them for fear of undermining the competitiveness of their own currencies. “Willy nilly,” Mr McKinnon says, “foreign governments cannot avoid being important creditors of the United States.” China, for one, added $60 billion to its reserves in the year to June by ploughing most of its trade surplus with America back into American assets.

This is not the first time America's external deficits have raised alarm. In 1966, as America's post-war trade surpluses began to dwindle, *The Economist* ran an article entitled “The dollar and world liquidity: a minority view.” According to this view, the build-up of dollar claims by foreigners was not a “deficit” in need of “correction”. Rather, the American capital market was acting like a global financial intermediary, providing essential liquidity to foreign governments and enterprises. In their own ways, Mr Davidson and Mr McKinnon echo this minority view today. A “correction” of America's current deficit, they say, would create more problems than it would solve. Whether the world's holders of dollars will always agree remains to be seen.

“Financial Markets, Money and the Real World” by Paul Davidson. Edward Elgar 2002.

“The International Dollar Standard and Sustainability of the U.S. Current Account Deficit” by Ronald McKinnon 2001. Available on www.stanford.edu/~ mckinnon/papers.htm

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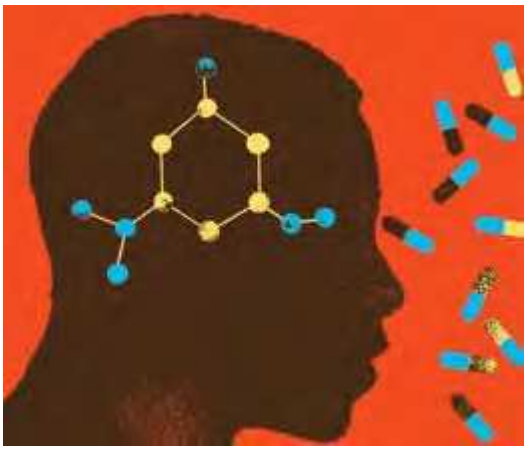
Intellectual property

Patently problematic

Sep 12th 2002
From The Economist print edition

An important new study shows the promise, and pitfalls, of intellectual-property rights for the poor



INTELLECTUAL-PROPERTY rights (IPR), which embrace patents, copyright, trademarks and trade secrets, were once considered an esoteric, and slightly dull, bit of commercial law.

No longer. Today, IPR law is the focus of intense interest, and it is not just lawyers who are paying attention. The original purpose of patents was to encourage innovation, and thus growth, by creating an incentive for inventors to disclose the details of their inventions in exchange for a limited monopoly on exploitation. Some argue that the modern system of IPR law is having the opposite effect—delaying the diffusion of new technology.

John Barton, a law professor at Stanford University, wants to see both rich and poor countries start thinking of IPR more as a development tool, and for them to reconsider the notion that strongly protecting the rights of inventors is automatically good for all. For the past year, Dr Barton has chaired the Commission on Intellectual Property Rights, a body of lawyers, academics, a bio-ethicist and an industry executive convened by Britain's Department for International Development to look at how IPR can work to the benefit of the world's poor countries.

The commission's report, published on September 12th, sets out detailed recommendations for how developing countries should craft IPR to suit their conditions. Its central message is both clear and controversial: poor places should avoid committing themselves to rich-world systems of IPR protection unless such systems are beneficial to their needs. Nor should rich countries, which professed so much interest in “sustainable development” at the recent summit in Johannesburg, push for anything stronger.

All together now

There was a time when countries could go their own way on intellectual-property rights, and introduce legal protection for creators whenever they thought it appropriate. For most of the 19th century, America provided no copyright protection for foreign authors, arguing that it needed the freedom to copy in order to educate the new nation. Similarly, parts of Europe built their industrial bases by copying the inventions of others, a model which was also followed after the second world war by both South Korea and Taiwan.

Today, however, developing countries do not have the luxury to take their time over IPR. As part of a trade deal hammered out eight years ago, countries joining the World Trade Organisation (WTO) also sign up to TRIPS (trade-related aspects of intellectual-property rights), an international agreement that sets out minimum standards for the legal protection of intellectual property. The world's poorest countries were given until 2006 to comply in full with the requirements of the treaty.

Contrary to popular perception, TRIPS does not create a universal patent system. Rather, it lays down a list of ground rules describing the protection that a country's system must provide. These extend IPR to include computer programs, integrated circuits, plant varieties and pharmaceuticals, all of which were unprotected in most developing countries until the agreement. Patent rights are valid no matter whether the products are imported or locally produced, and protection and enforcement must be extended equally to all patent holders, foreign and domestic.

Although many poor countries feel that TRIPS gives them a raw deal—all cost and scant benefits—few want to see the agreement dismembered or removed from the WTO, according to Rashid Kaukab, at the South Centre, a think-tank based in Geneva. That is largely for fear of what might take its place. Instead, a few developing countries, such as India and Brazil, are starting to flex their muscles when it comes to the battle between western standards of IPR protection and matters of public interest, such as health and farming. As the commission points out, the wording of TRIPS gives poor countries considerable latitude to look out for themselves when introducing new systems of IPR protection. It also suggests a few ways that they can make the most of this flexibility in a number of important areas:

• **Drugs** Much of the recent debate over the impact of IPR on the poor has centred on the issue of access to expensive medicines. On paper, many of the world's least-developed countries have laws which provide patent protection for pharmaceuticals. In practice, few enforce them. Spurred on by a victory in April 2001 against drug companies fighting patent reform in South Africa, developing countries issued a declaration at the WTO meeting in Doha last year. This asserted the primacy of public health over IPR. They resolved that the world's least-developed countries should be given at least until 2016 to introduce patent protection for pharmaceuticals.

On September 17th, the WTO council responsible for TRIPS will consider a far trickier proposition in the declaration: how to make compulsory licensing (the manufacture and marketing of a patented drug without the patent-holder's consent) work for the poorest. TRIPS already permits compulsory licensing under certain conditions, including national emergencies. This is fine for countries such as Brazil, which have domestic drug industries to copy the medicines. Brazil has, indeed, used the threat of compulsory licensing to wring price discounts out of drug companies, a ploy which the commission, somewhat controversially, supports.

The problem is what to do with countries which have no drug makers. For the moment, they can import generic copies from the likes of India, but come 2006, when those exporters are supposed to have fallen in with the TRIPS line, who will supply the drugs?

• **Education and research** Alan Story, a specialist in IPR at the University of Kent, in Britain, reckons that copyright, particularly as it pertains to education and research, will be the next big battleground. Those countries that have signed up to TRIPS have also accepted international copyright rules. Although these allow some unauthorised copying for “fair use” or personal consumption for education or research, the commission worries that these exceptions are too limited, and that copyright may hamper access to textbooks, journals and other educational material in poor countries, by requiring the consent of, and likely payment to, the publisher prior to copying.

The commission is even more worried about the Internet, which has great potential for broadening access to education in poor countries, but in which encryption technologies can override the principle of fair use. Some publications, such as the *British Medical Journal*, allow free online access for people in poor countries. The commission would like to see more of this. In the meantime, it recommends that developing countries allow users to sneak round technical barriers such as encryption, to gain access for fair use. Not surprisingly, software makers are unenthusiastic.

• **Traditional knowledge** The most glaring conflict between rich and poor over intellectual property comes from the misappropriation of “traditional knowledge”—such as ancient herbal remedies that find their way into high-priced western pharmaceuticals without the consent of, or compensation to, the people who have used them for generations. Often, patent examiners are simply unaware that the plant variety which an enterprising businessman is trying to patent has been used for centuries by a tribal community half a world away. The commission recommends that countries create databases to catalogue such traditional knowledge (India is already doing so), and urges that consulting such databases should be made a mandatory part of patent examinations the world over.

More than this, however, Kamal Puri, a lawyer at the University of Queensland, Australia, argues that new systems of IPR protection are needed for traditional knowledge. That is because its communal ownership, uncertain date of creation and unwritten form does not fit the requirements of western systems of IPR. On September 17th, a model law, drafted by Dr Puri and co-sponsored by UNESCO, will be unveiled at a meeting of Pacific island states in New Caledonia. The law gives traditional users jurisdiction over native knowledge, and requires that those who wish to commercialise it must seek the users' consent. All transactions must be registered with a tribal authority, which will deal with subsequent disputes.

Even when armed with these weapons, poor countries will have a hard time deploying them. Drafting IPR

legislation and setting up a patent office that has modern information-technology systems and trained examiners does not come cheap or easy. Neither does establishing judicial, customs and competition authorities, and police services to enforce IPR rules. The World Bank reckons that it costs at least $1.5m to create a working system, plus recurrent costs.

Moreover, inventors in poor countries find it tough to use patent systems in the rich world. Merely securing a patent from America's patent office costs at least $4,000. Defending it in court can cost millions. The commission identifies several ways in which rich countries could open their domestic IPR systems, including discounted fees and subsidised technical assistance. It also suggests they should help poor countries to set up their own systems without saddling them with rich-world standards until they are ready to benefit from them. Inventing a way to do that might be worth a patent in its own right. Those who heed the commission's report, however, might well resist the claim.

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Nanoelectronics

Small wonders

Sep 12th 2002
From The Economist print edition

Traditional silicon memory chips are about to face a challenge

Breaking the memory gridlock

SMALL achievements, it seems, are big news these days. Within the past six months, both Hewlett-Packard (HP) and IBM have burst through the silicon ceiling. They have demonstrated circuitry based on radically new technologies that have a much higher density of components than any achieved by today's leading chip manufacturers. This opens up the possibility of storing gigabits of information in an area smaller than a fingernail. And although the two computer-makers' technologies are different, both point towards the end of the age of silicon.

At a meeting of Sweden's Royal Institute of Technology in Stockholm on September 9th, Stanley Williams, director of quantum science research at HP, announced that his group had created the highest density of electronically switchable memory so far. “Electronically switchable” means that each bit of memory can be flipped on and off by a current, without the need for any moving parts.

Earlier this year, an IBM project named Millipede demonstrated even higher potential storage densities. Millipede uses an array of tiny silicon cantilevers, with downward-pointing tips (“feet”) that punch indentations into a thin plastic film which moves beneath them. From a manufacturing perspective, though, Millipede may be less attractive than HP's new device, because it contains moving parts and is thus likely to require a higher degree of manufacturing accuracy.

HP's announcement was significant in three ways beyond the question of mere density. The memory bits are made of molecules known as rotaxanes, rather than silicon, making this the first significant demonstration of so-called molecular electronics. Second, it demonstrates the reliability of a new contact-printing technique that should allow molecular-electronic components to be printed cheaply. The third advantage is that HP has shown that such components can be read and “written to” in an economic way. Although the demonstration device contains only 64 bits, the tests suggest that scaling up should prove to be straightforward. One square centimetre of such molecular-electronic wizardry should therefore be able to store 6.4 gigabits of information.

The individual bits are not yet single molecules. Each consists of about 1,000 rotaxane molecules trapped in a minute junction between wires made of platinum and titanium. The wires themselves are only 40 nanometres (billionths of a metre) wide. Although HP is also looking at other metal/molecule systems, the wires are so tiny that it is not prohibitively costly to use precious metals.

The memory bits (ie, the ones and zeros of the binary arithmetic used by computers) are written into each cluster of molecules by changing the structure of those molecules. A small voltage is applied across the clusters using current in the metal wires. The resulting change in structure alters the electrical resistance of the molecules by a factor of 10,000—making it easy to measure whether the state of the cluster represents a “one” or a “zero”.

Researchers in the field do not yet understand the manoeuvrings that change the molecules' resistance. However, they do know that a phenomenon called quantum tunnelling is involved. During quantum tunnelling, one of many strange physical effects that occur at small scales, electrons spontaneously disappear from one place and reappear nearby.

The components of the circuitry are stamped on to the chip using an inexpensive technique called nano-imprint lithography. A master mould is carved out of silicon, using a precise beam of electrons. The resulting mould is pressed into a layer of polymer, and the trenches created in the polymer are filled with platinum. After that, a single layer of rotaxane is deposited on top and, once the mould has been rotated by 90°, another set of trenches and wires is made on top of the rotaxane.

Perhaps the most important part of HP's announcement is its demonstration of a “logic circuit” for addressing each bit of molecular memory. A logic circuit has several inputs and a single output. It is the physical embodiment of a mathematical equation and, as in an equation, the value of the output depends on the state of the inputs. The practical benefit of this is that any particular bit of memory can be addressed without having to measure the state of every single pair of wires.

One of the advantages of HP's device is that the memory is “non-volatile”. In other words, once the switches are flipped they stay that way. So memory will be retained even when the power is shut off. So far, HP's researchers have demonstrated that memory can be kept like this for four months. There is a snag. The switches typically work only 50-60 times before they start to degrade. On the other hand, as Dr Williams points out, with terabits of storage available, it may never be necessary to erase anything.

HP says that its molecular electronics will take a minimum of five years to commercialise. It intends to do it in part by publicly disclosing its results in order to “seed its own competition”. Initially, molecular electronics would be aimed at niche markets such as flash memory for cameras. Ultimately, though, it should compete with DRAM, the most common form of silicon-based memory

If HP or IBM (or Intel or Motorola, which are also working on molecular electronics) can commercialise their nano-scale devices, the memory-chip industry will leap ahead of predictions for its future based on silicon semiconductors. HP's demonstration has about ten times the density of memory of the best silicon DRAM memory on the market today. With the cost of new fabrication plants for silicon chips running to billions of dollars, a technology that is both better and cheaper than silicon-based memory can be expected to disrupt the status quo.

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Irritating coins

Allergic to the euro

Sep 12th 2002
From The Economist print edition

Why the euro may be a rash move

AP

A handful of trouble

IT IS not only Eurosceptics who can claim allergy to the euro. Anybody who is sensitive to nickel may also wish to handle the coins with care. Research published in *Nature* this week shows that one- and two-euro coins, when clutched in sweaty hands, release 300 times more nickel than is allowed by EU guidelines. Frank Nestle, a dermatologist at the University of Zürich Hospital, in Switzerland, was prompted to investigate the coins after hearing complaints in his clinic.

Even before euro coins became legal tender in January, there was consternation at the use of nickel alloys in their manufacture. It was argued that nickel ions leaching out of the coins as they corroded would cause hand eczema in the 15% of women and 2% of men who are already allergic, and might sensitise more of the population to nickel as well. However, the alloys employed in the euros—cupro-nickel and nickel-brass—have long been used to make hard-wearing coins that are difficult to forge. What was good enough for individual EU countries was surely good enough for the common currency.

But the results suggest that euros are worse than the coins they have replaced. The one- and two-euro coins release more irritating ions than a lump of pure nickel would. Dr Nestle worked in collaboration with Hannes Speidel and Marcus Speidel, two metallurgists, to find out why. The problem, they concluded, is the dashing two-tone design. The outer ring and the inner circle are made from different alloys, which have different electric potentials. Clutch a coin in a sweaty hand and the metals connect through the salty solution to make a mini-battery. The tiny current produced is harmless in itself, but the flow of charge drags nickel ions out of the coin and on to the skin.

Stephen Carter, a researcher at LGC, a chemical laboratory in Britain, was asked to test the coins before they were introduced into circulation. He also reported, in a paper published in *Contact Dermatitis* in March 2001, that nickel release from the euro coins exceeded EU guidelines. However, he explains that the exposure limits are for prolonged contact—as with jewellery or a watch. Coins are not usually in the hand for long enough to do any harm when they pass straight from purse to retailer.

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Literary biography

A small man of great stature

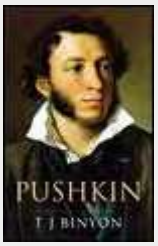
Sep 12th 2002
From The Economist print edition

A new biography cleans the mythological encrustations from Russia's greatest poet and details a life that was as extraordinary as it was dramatic

RUSSIAN writers have been poorly served by biographers in their own country. Their lives may be celebrated in worthy and uplifting volumes, but truebiographies are rare. Russian biography originated in saints' lives, as it did in western Europe, but the closely interrelated evolution of religion and literature in Russia left critics with a squeamishness—exacerbated by censorship—about probing the lives of writers. This is particularly true of persecuted poets like Aleksandr Pushkin who acquired almost divine status as martyrs and prophets when they died, often tragically and at a young age.

When, as Russia's Shakespeare, Pushkin was co-opted after the revolution as an icon of Bolshevik propaganda, biography again became hagiography, this time of a political kind. The centenary of Pushkin's death in 1937 marked the zenith of his personality cult, but also its nadir: the purging of several scholars involved in the Academy of Science's edition of his collected works meant publication was completed only in 1949. That even émigré critics should have been shocked by an irreverent essay about Pushkin written by an ex-dissident in the 1970s points to the aura that continued to surround his name long after the end of Stalinism.

Pushkin: A Biography
By T.J. Binyon



HarperCollins; 731 pages; £30

Buy it at Amazon.co.uk

How refreshing, then, to read a straightforward, scholarly account of Pushkin's life informed by all the best qualities of English biographical writing and free of ideological constraints. Scrupulously researched, lucidly and objectively written, with an admirable lightness of touch and a good dose of dry humour, T. J. Binyon's “Pushkin” deserves to join other English biographies that are being translated into Russian.

Bridgeman Archive

The author will be a dark horse to those who know him only from his frequent reviews of detective fiction. But Mr Binyon, a teacher of Russian at Oxford University, has finally redeemed his debt to the literature he actually lectures in. Although his book came too late to coincide with the bicentenary of Pushkin's birth in 1999, it has been worth the wait.

Standing no more than five feet (1.5m) tall, Pushkin may have been short of stature physically, but in literary terms he was a giant. The first world-class writer to emerge in Russia, and the author of the first Russian novel, “Eugene Onegin” (albeit in verse), Pushkin wrote in every conceivable genre, and often with an irony that seems astonishingly modern to the contemporary reader. He is renowned as the founder of the Russian literary language, but the deceptively simple lines of his poetry (whose expressive power and finesse have been compared to the music of Mozart) have proved notoriously difficult to translate. It is for this reason that Russia's undisputed national poet is not better appreciated outside his homeland.

Mr Binyon's work follows the trajectory of the poet's life in conventional fashion, his crisp chapter headings—“Ancestry and Childhood, 1799-1811”, “In Search of a Wife, 1826-29”, “The Tired Slave,

1833-34”—suggesting something of the businesslike way this biography has been tackled. Mr Binyon does not use the life to explain the works. With the exception of “Eugene Onegin”, which is both a parody and a prophecy of his own destiny, Pushkin's protean writings are mentioned only in passing. Few of his celebrated lyrics are cited, and then usually in connection with an infatuation, of which there were many.

Mr Binyon's focus instead is on the minutiae of the day-to-day life of the poet, who does indeed emerge here as a rounded and complicated human being. This is no mean achievement. The curly-haired great-grandson of impoverished Russian aristocrats and an Abyssinian boy given to Peter the Great, Pushkin was a down-to-earth, outspoken man with long fingernails and slovenly habits who liked to write best of all in bed. Despite having what he called a “monkey's face”, he enjoyed numerous amorous liaisons before his marriage, fuelling an uninhibited erotic imagination that expressed itself in reams of unpublishable verse.

There were also few outlets for his wit and erudition, and even the reader acquainted with the bare outlines of Pushkin's biography (privileged upbringing, rebellious youth, exile, personal censorship by the tsar, marriage to a society beauty, untimely death in a duel) will be struck by the suffocating lack of creative freedom so vividly conveyed here. Pushkin's personal correspondence was intercepted, his movements monitored and his life closely tied to that of the court. Not only did Tsar Nicholas I's decision to oversee his career oblige him to submit all his manuscripts for inspection, but his perennially desperate finances entailed humiliating negotiations with the tsar's chief of secret police over his loans. And when Pushkin's wife caught Nicholas's eye, the increasingly beleaguered poet was coerced into becoming a junior courtier so that she could attend all the right balls.

The recklessness with which Pushkin fought duels and even gambled away some of his own manuscripts is no doubt directly attributable to the need to assert some kind of independence in such a repressive world. Although Mr Binyon provides pithy explanations where necessary, the profusion of Russian names and places may seem bewildering and it is best to come to this biography with at least a rudimentary knowledge of Pushkin's life and work. That said, the long final chapter recounts with true Pushkinian detachment the machinations of Georges d'Anthès, the unscrupulous Frenchman who was the cause of the poet's wasteful death, at the age of 37. It makes for a gripping end to an impressive work.

Pushkin: A Biography.
By T.J. Binyon.
HarperCollins; 731 pages; £30

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New British fiction

Good bad and plain bad

Sep 12th 2002
From The Economist print edition

HAD enough of novels that make obvious sense? Books with a conventional plot? Stories that actually go somewhere? Characters you can relate to? Then try the latest offerings from Zadie Smith and Nicola Barker. They are probably two of the most frustrating novels you will read this year.

“The Autograph Man”, a follow-up to Ms Smith's smash debut, “White Teeth”, is an uneasy mix of “Sunset Boulevard” and J.P. Donleavy's “The Ginger Man”. The cast revolves around Alex-Li Tandem (the 27-year-old son of a Jewish mother and Chinese father), his frustrated couplings with Esther (who wears a pacemaker that he likes rubbing between his thumb and forefinger), his search for religious certainty among the minutiae of the Kabbalah and Zen Buddhism, and his career as a collector, verifier and occasional forger of celebrity autographs.

The real love of Alex-Li's dementedly self-absorbed existence is the novel's Norma Desmond, a reclusive former screen beauty named Kitty Alexander. Alex-Li's quest for her rare signature takes him and many bizarre hangers-on to a series of autograph auctions, which form the backdrop to this endless, and endlessly weird, adventure.

“The Autograph Man” is neither properly picaresque nor, despite the boast in the cover blurb, terribly funny. The characters are shrill, cartoon-like figures, and the bubblegum text is so distended with italics, capital letters, lists, diagrams, poor jokes and *faux* parables that you end up wanting to stick it to the underside of your chair and leave it there.

“Behindlings”, Ms Barker's fourth novel, concerns a weird, grotty fellow called Wesley; some kind of practical joker, apparently, whose slightly sinister antics have earned him a band of groupies, or “behindlings”, who follow him devotedly on his peregrinations around Canvey Island in the Thames estuary. As well as the various behindlings, there's another character, Katherine Turpin, whom Wesley has wronged in the past, though it's never clear exactly how. (There are allusions to the theft of an antique fishpond.)

Ms Barker won the IMPAC prize for her previous novel, “Wide Open”. She certainly writes well. But “Behindlings” is maddeningly bereft of most of the ordinary pleasures of the novel. Instead, it's full of stream-of-consciousness ramblings and interminable descriptions of the grim Canvey landscape. Take a couple of examples. “Then finally, the refineries. Balanced on the coastline like a clutch of steel reptiles. Like iguanas, nodding complacently—perhaps in friendship, possibly in challenge—towards the hoary, pewter, slate-smashed sea. Dry-clawed, shining, harsh, bulbous, slithering, *contained*, pristine.” A few pages later a character throws a key into the water. “He diligently supervised its multiple adventures—its brief spiralling rise, its determined fall (like a sycamore seed, a helicopter blade, an injured grouse on the wing), its eventual splash-landing, its half-hearted floating, its gradual submerging, with a strong, with a wicked, with a *powerful* sense of satisfaction.”

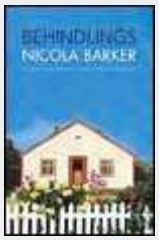
Why settle for a descriptive phrase when a whole prose-poem will do? This constant elaboration is what pads the book out to such length. But whereas Ms Smith has written a bad book badly, Ms Barker has written a bad book with tremendous style and individuality. The main problem with

The Autograph Man
By Zadie Smith

Random House; 400 pages; $24.95.
Hamish Hamilton; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Behindlings
By Nicola Barker



Flamingo; 534 pages; £10.99.
To be published in America by Ecco Press in December

Buy it at
Amazon.co.uk

“Behindlings” has to do with excess: it's too long, too woolly, too teasingly obscure. Yet it is full of gorgeous prose, and might well have made an intriguing short story.

“Behindlings” is a failure, but the quality of the writing confirms Ms Barker as a genuine talent. Zadie Smith's “The Autograph Man” is just a failure, and while it is true that this is a second novel and second novels are probably the hardest to write, it would seem only to confirm, sadly, that all the fuss about Ms Smith may have been seriously misplaced.

Things are looking down for Ms Smith

The Autograph Man.
By Zadie Smith.
Random House; 400 pages; $24.95.
Hamish Hamilton; £16.99

Behindlings.
By Nicola Barker.
Flamingo; 534 pages; £10.99.
To be published in America by Ecco Press in December

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New Irish fiction

Lost and lovely

Sep 12th 2002
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IN THE sinister world of William Trevor's last two novels, “Felicia's Journey” and “Death in Summer”, child abductors and murderers lurked below the glassy surface of his prose. His new book has a less twisted undertow. If Mr Trevor deals in good and evil, redemption here rather than damnation is the keynote.

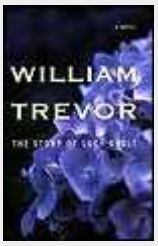
It begins in Ireland in 1921. Captain Gault, last in line of a Protestant Ascendency family, fires a shot at three youths bent on an arson attack at his country house. One is wounded, and the Gaults decide to leave their ancestral home. Lucy, their nine-year-old daughter, distraught at the prospect, runs away. Instead of being found and scolded as she expects, she breaks her ankle in the woods. Meanwhile, her clothes which she lost on a secret swimming expedition a while back, are found on the seashore. Her grief-stricken parents, believing her to have drowned, leave for Europe and cut all ties with home. By the time the half-starved Lucy is discovered, the incompetent local lawyer is unable to trace them.

Lucy grows up, hermit-like, in the old house with two loyal family retainers who remain there. She works her way through the books in the library, embroiders and communes with nature, while her unknowing, exiled parents wander through Italy and Switzerland. At 21, her isolation is broken by the arrival of a young man with whom she falls in love, but her sense of guilt and belief that her life must remain on hold until her mother and father return make her reject his proposal. Meanwhile, we follow the descent into madness of the boy who was shot, who is also tormented by guilt at the consequences for the Gaults of his actions. Late in life, he and Lucy meet. Her visits to his asylum offer them both some sense of closure, “the gentle fruit of such misfortune's harvest”.

Mr Trevor's writing here is gentle too, with an elegiac elasticity very different from the tense feel of “Felicia's Journey”. That novel had all the horror of “Bluebeard”. This one is also, at root, a fairytale, but a kindlier fable of loss and longing lit by moments of rare beauty.

The Story of Lucy Gault.
By William Trevor.
Viking Press; 288 pages; $24.95.
Penguin Viking; £16.99

The Story of Lucy Gault
By William Trevor



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About sponsorship

German history

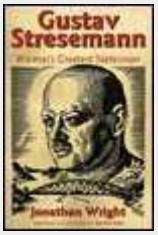
Could he have saved Weimar?

Sep 12th 2002
From The Economist print edition

Though little known today, he was one of the 20th century's great might-have-beens

GUSTAV STRESEMANN, Germany's foreign minister, died in early October 1929, just weeks before the Wall Street crash that gave Hitler his opportunity. An estimated 200,000 people watched his funeral procession in Berlin and Count Harry Kessler noted in his diary, “It is an irreparable loss whose consequences cannot be foreseen.” The sense of shock was equally great outside Germany. Aristide Briand, Stresemann's ally in the Franco-German rapprochement of the 1920s, reportedly said, “Order a coffin for two.”

Gustav Stresemann: Weimar Politician and Statesman
By Jonathan Wright



Oxford University Press; 592 pages; $35 and £30

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Stresemann's premature death from a stroke—he was only 51—presents one of the great what-if questions in modern German history, like the death of the liberal-minded Kaiser Friedrich III in 1888 after a 100-day reign. Stresemann was, after all, younger than Konrad Adenauer. Could he have prevented the Weimar political system from buckling in the face of National Socialism? What if Stresemann, not the conservative Hindenburg, had become the candidate of the democratic parties in the 1932 presidential elections, a possibility he discussed before his death? Jonathan Wright speculates intelligently on these counterfactuals at the end of his fine new biography. He offers a hard-headed verdict, pointing out the constraints within which a surviving Stresemann would have operated. They included a fragile political base within his own splintered and self-destructive German People's Party, a group of centre-right liberals which supported him with reluctance even during the relatively prosperous mid-1920s when Stresemann was scoring his greatest diplomatic achievements.

Stresemann was the youngest child of a lower middle-class family in Berlin. Like Matthias Erzberger, a leader of the Catholic Centre party, he was one of the new men from modest backgrounds who came to prominence in Wilhelm II's Germany. Mr Wright is excellent on this new generation of professional politicians who lived, in Max Weber's terms, from rather than for politics. After writing a dissertation on the bottled-beer industry, his father's business, Stresemann started in politics organising the Saxon chocolate manufacturers against the powerful sugar cartel. It was a perfect introduction to the rancorous interest politics that bedevilled German liberalism before and after the first world war.

Stresemann rose initially in the National Liberal Party, where his interest in domestic reform coupled with imperialism made him typical of his generation. A fervent annexationist during the war, he then faced a difficult adjustment to defeat and revolution. During the attempted Kapp putsch in 1920 Stresemann remained equivocal about defending the new regime. A major part of this book is taken up with explaining how the critic of theWeimar republic and the Versailles treaty turned into a committed democratic politician and advocate of détente.

Partly, he saw no alternative. He was a *Vernunftrepublikaner*—a believer in the republic on pragmatic grounds rather than from deep conviction—as well as an instinctive consensus-builder (“I incline by nature much more to conciliation than to conflict.”) But Mr Wright argues that Stresemann developed a genuine emotional attachment to the republic, which was strengthened by the right-wing assassination of Walter Rathenau.

Pragmatism-plus is also Mr Wright's explanation for Stresemann's policies as German foreign minister, a post he held from 1923 until his death. The Dawes plan, the Locarno treaty and German entry into the League of Nations were all the work of a statesman who had seen the bankruptcy of the alternative during the French occupation of the Ruhr in 1923. The book argues that Stresemann's talk of peace and

European economic integration developed into something more than *Realpolitik*. Mr Wright is fair to the arguments made by Stresemann's critics. He notes the differences between German policy towards the western and eastern frontiers, and recognises that the dissonance between the two halves of Stresemann's policy—détente and revision of Versailles—was growing after 1925-26. Yet his overall judgment echoes that of Austen Chamberlain, who thought that, by degrees, “Stresemann became a convert to his own policies.”

Another British commentator, Claud Cockburn, saw it differently: Stresemann had “discovered that the way to get away with being a good German was to pretend to be a good European.” Mr Wright rejects this while noting the parallel with debates over German *Ostpolitik* after 1945. His well-documented, carefully argued book is a major contribution to our understanding of Stresemann and of German foreign-policy interests in the 20th century.

Gustav Stresemann: Weimar Politician and Statesman.
By Jonathan Wright.
Oxford University Press; 592 pages; $35 and £30

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About sponsorship

Film festival

Nuns, Chechens and Aborigines

Sep 12th 2002 | VENICE
From The Economist print edition

The right films won, mostly

EPA

Cruelties of the cloth

THE jury at the Venice film festival gave its prizes with care this year, rewarding passion more than bluster, and human feeling more than skill, though it did miss two remarkable films.

One was “The Tracker”, by a Dutch-born, Australian-based director, Rolf de Heer, who made his name in Venice nine years ago with “Bad Boy Bubby”. Mr de Heer's new film, described by some as a western in the outback, is set in 1922 and features a three-man mounted posse hunting for an Aborigine, alleged to be a murderer. They are led, on foot, by an Aboriginal guide, played by David Gulpilil, an actor, dancer and musician imbued with all the quiet charisma of a cinematic Nelson Mandela.

Early on, one of the posse is speared by an unseen hand. A second, an arrant racist, retaliates by slaughtering many of the tribesmen they meet. The third one ends up chastened, like the audience. What lingers, apart from vicarious guilt, is the memory of a vast landscape, bristling with menace, that has to be scanned like a Jacques Tati film for small details, tiny movements, sudden threats.

No less accomplished in a quite different vein is Patrice Leconte's “L'homme du train”. The man from the train is a roughneck played by Johnny Hallyday, a French pop star with a lined face and highlights in his hair. He has arrived by night in a small French town where he plans to rob a bank. In its deserted streets he encounters an elegant retired teacher, the fine-drawn Jean Rochefort, who lives alone in his late mother's old dark house. The teacher hankers for adventures he never had. The robber seeks refuge and is wistful for the education he lacked. Improbably, they strike up a friendship which lasts, or seems to last, beyond the film's double climax—botched robbery and the teacher's triple-heart-bypass surgery. Mr Rochefort draws on his recent experience of illness to evoke a subtle, delicate relationship between men of different strengths. For this performance he really should have won the award for best actor that went instead to Stefano Accorsi, playing Dino Campana, an insane Italian poet, in an opulent true-life romance, “A Journey Called Love”, whose plot, acting and music makePuccini seem like a minimalist.

Still, the Venice jury gave at least one deserved acting prize, for young performers, to Moon So-ri, an exquisite Korean beauty who played a young woman suffering from cerebral palsy in love with a retarded youth in Lee Chang-dong's “Oasis”, for which he won the special director's award. The scene in which the girl's deformity dissolves as she dances with her lover was especially touching.

Just as memorable were the psychiatric patients in Andrei Konchalovsky's “Dom Durakov”—(The House

of Fools)—which won the jury's second big prize. A return to form after some of Mr Konchalovsky's recent American work, the film recalls the best of those made by his brother, Nikita Mikhalkov. It portrays a run-down mental hospital on the Russian-Chechen border, swept into the larger madhouse of war. The staff flees the double bombardment. Troops from both sides invade and search the premises. One of the more stable patients believes she has fallen in love with a reluctant soldier. He responds, but only faintly—until he sees in the asylum a true refuge from the war. At first, the actors playing the inmates seem over the top; in fact, most of them were actual patients. In its triple setting—isolation, incarceration and invasion—their plight is remarkably well evoked.

Raw emotion thus transcended the collective art of film making. And the Venice jury felt it from the start. In the first two days of the festival, when less compelling work tends to be screened, one film transfixed every kind of audience. This was Peter Mullan's “The Magdalene Sisters”. Fiction based on fact, it rightly won the Golden Lion award.

Its setting is one of the Magdalene asylums set up in 19th-century Ireland by the Catholic Sisters of Mercy as refuges for so-called fallen women. Their good intentions paved the road to Dickensian workhouses, if not to hell. By 1996, when the last one closed, countless women had endured the torment suffered during the 1960s by the young women in the film—one a rape victim, two unmarried mothers parted from their children, and a poor orphanage girl just too pretty for her own good. Shunned by their families, imprisoned, badly fed, forced to work as unpaid laundresses in rough uniforms ten hours a day, seven days a week, the survivors confirm the truth of the story Mr Mullan tells.

Although best known as an actor in Ken Loach's “My Name is Joe”, Mr Mullan has proved that he is also a sensitive writer and director with a gift for turning out flawed heroines and believable villains. When *L'Osservatore Romano*, the Vatican's semi-official mouthpiece in Italy, predictably attacked the film, Mr Mullan calmly pointed out that cruel, self-righteous bigotry, contempt for women and a terror of the power of sex are not unique to the Roman Catholic church. Which may be why his film has such universal appeal.

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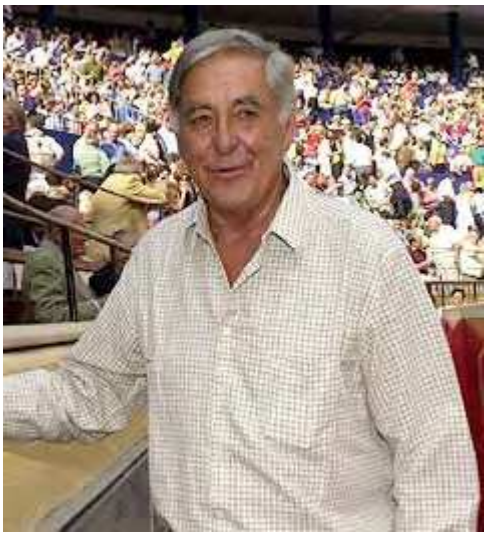
About sponsorship

Manolo Chopera

Sep 12th 2002
From The Economist print edition

Manolo Chopera, tycoon of bullfighting, died on September 6th, aged 75

Miguel Calvo Alejo



IT WAS a puzzle to Manolo Chopera that anyone should object to bullfighting. Was it not part of Spanish culture? When non-Spaniards continued to be unpersuaded, Mr Chopera would dig deeper into history. Bullfighting had played a part in the very foundations of European culture. Think of the story of the Minotaur, the creature with a bull's head and a man's body, which had the unfortunate habit of eating people until it was killed by Theseus. Was that not an early example of bullfighting?

Mr Chopera would be heard out, usually politely, but he rarely won over opponents to bullfighting. The ceremony of killing the bull is either loved or loathed. There is no middle way. Ernest Hemingway became its most famous supporter in the Anglo-Saxon world, calling it an art: “not a sport but a tragedy”. But he was already hooked on violence before he saw his first bullfight, and anyway admired just about everything about Spain. An earlier American writer, Mark Twain, was just as ferociously opposed to the bullring. In a bitter story, bereft of his usual good humour, Twain has a character saying of a Spanish bullfight: “Well, it is perfectly grand, perfectly beautiful. Burning a nigger don't begin.”

At least at home Mr Chopera did not have to be on the defensive. There is some opposition to bullfighting in Spain but set against that is its huge popularity. Critics of bullfighting sometimes claim that it is kept going only because of the support of curious tourists. But the reality is that in most towns with bullrings the number of local supporters is rising.

These days audiences include many women shouting their encouragement to the matadors in their gold-trimmed suits, stockings and white shirts. Jesulin de Ubrique, a matador much admired for his bold style, appeared in a *corrida* staged one evening exclusively for women. Some 9,000 packed the stadium and saw six bulls killed. Purists were appalled. The bullfight was supposed to be a re-enactment of the traditional contest between man and beast, not a kind of pop concert. Was this the way the bullfight was going? If it were, Mr Chopera could take some of the credit, or blame.

Only the best

Nearly all the bullfighting in Spain, and much of it in Latin America, was under the control of Manolo Chopera. He promoted the careers of the top matadors and saw that they fought only the best bulls. For some 30 years wherever bulls were ritually put to the sword Mr Chopera was the impresario: in the Basque region or in southern Spain around Seville; in Mexico, Venezuela, Ecuador and Peru (where Pizarro, the Spanish conqueror, is said to have dispatched the country's first bull in 1540). He owned Las Ventas in Madrid, perhaps the most important bullring in the world, which seats 25,000 spectators with a box for royalty, and has an operating theatre for matadors who misjudge the bull's cunning and a small chapel for those beyond help.

His father, Pablo Martinez, bred horses for picadors, the horsemen who take part in the preliminaries of a bullfight before the matador appears, provoking the bull to attack them. For generations the Martinez family had bred the heavily-built horses, but now he feared that bullfighting would decline as Spain was being rebuilt after the civil war. He sent his son to France where he gained a degree in chemical engineering at Toulouse university. Manuel Martinez, as he then was (Manolo Chopera is an untranslatable slang name everyone called him), had little enthusiasm for engineering and preferred to

work with horses. When his father died in 1968 Mr Chopera took over the business and from it created an empire of blood and sand.

Some critics said that bullfighting flourished in Spain because the country was backward under General Franco, the Spanish dictator until his death in 1975. But Mr Chopera said that blood sports were popular in all countries, poor or rich. You might expect cock fighting to be popular in a poor country such as the Philippines, but it was also tolerated in three states of America. Hollywood films such as the Oscar-winning “Gladiator” fed the lust for blood. In England, Parliament had not been able to stop foxhunting. Highly-paid football stars in Britain roused the crowd with brutal, and damaging, attacks. The spectacle might be nasty but it was human.

Mr Chopera rejected a proposal that Spain should make bullfighting more humane. In Portugal it is illegal to kill the bull in the ring. Promoters in other countries have tried to introduce “humane” bullfighting, among them Russia where the gentle Slavs said it still sounded cruel. Mr Chopera agreed. The bull died anyway, off-stage, while the matador was deprived of his prize. Better to accept that humans were hunters, carnivores at the top of the food chain who enjoy a steak.

The obsequies for Manolo Chopera have been many and ornate. It was noted by some that he died at around six in the evening, just as the day was cooling and the crowds were taking their seats in Las Ventas. With perfect timing the man who had made the show possible would be present in spirit to check all was in order. It sounds mawkish, but perhaps not if you are a bullfighter.

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Overview

Sep 12th 2002
From The Economist print edition

America's unemployment fell to 5.7% in August, from 5.9% in July. But the labour market remains weak, with no growth in private-sector jobs in the past two months.

GDP in the **euro area** grew at an annual pace of only 1.4% in the second quarter. Industrial production fell by 2.0% in Germany in the year to July; in Spain, it grew by 1.8%. Germany's trade surplus rose above $10 billion in July, lifting its 12-month surplus to $104.5 billion.

Japan's GDP growth in the second quarter was revised up from 1.9% to 2.6% at an annual rate. Retail sales fell by 4.8% in the year to July. Meanwhile, producer-price deflation slowed to 1.3% in the year to August.

In **Britain**, the number of people claiming unemployment benefit fell to 943,300 in August, its lowest for 27 years. But the government's preferred internationally comparable measure of unemployment rose to 5.2% in the three months to July.

The prospect of war with Iraq pushed **oil prices** briefly over $30 a barrel at mid-week. Yet world **stockmarkets** regained much of the ground recently lost. The Dow Jones Industrial Average rose by 1.9% over the week. France's CAC 40 surged by 7.2%.

The **dollar's** trade-weighted value rose by 1.7%; the euro and the yen each fell by just over 1%.

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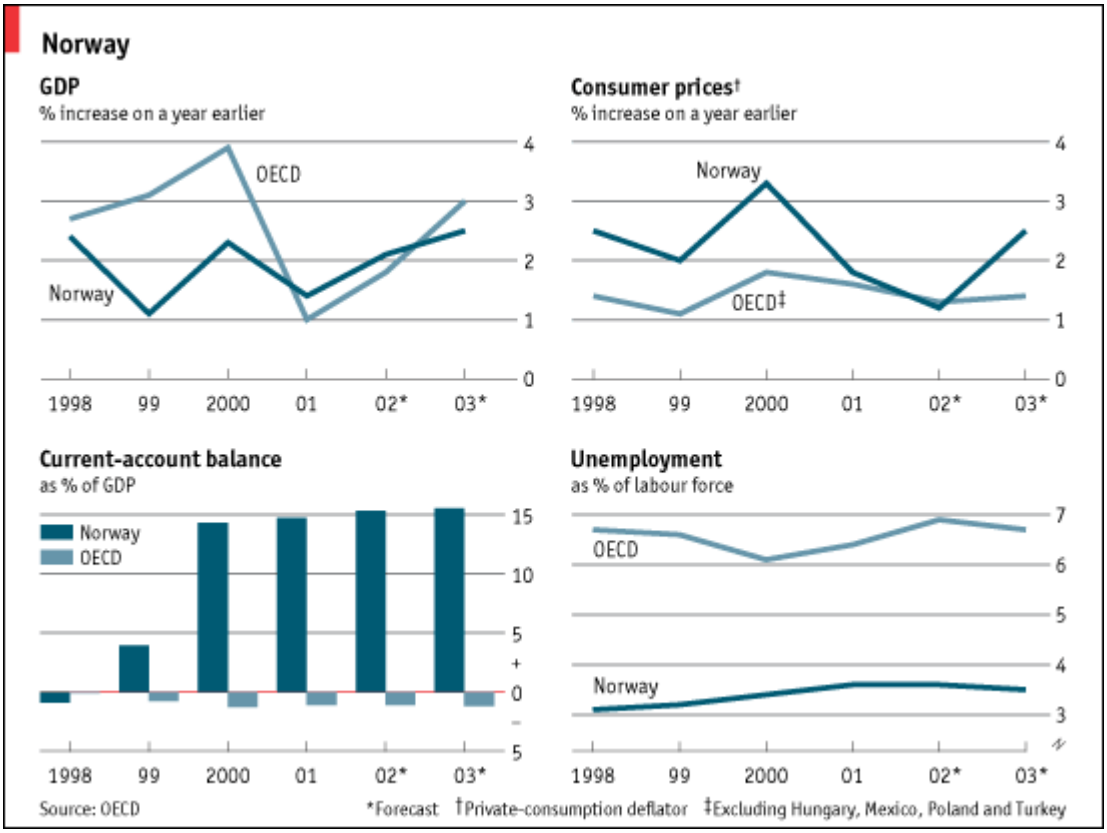
Norway

Sep 12th 2002
From The Economist print edition



High oil prices have given Norway a huge current-account surplus. Assuming prices of $25 a barrel, the OECD forecasts a surplus of 15% of GDP this year and next. However, Norway's oil wealth complicates the management of its economy. The government is loosening fiscal policy after the budget surplus reached 14% of GDP last year. But falling financial markets have cut the value of Norway's overseas investments and somewhat reduced the government's room for manoeuvre. Although the oil-related rise in the krone has hurt competitiveness, GDP growth on Norway's mainland is expected to rise to 1¾% this year and 2½% in 2003. With the economy near capacity, looser fiscal policy means that monetary policy has to be tight. Interest rates were raised in July by a half-point to 7%. By pushing the krone up, high oil prices may obviate the need for more rate rises.

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Output, demand and jobs

Sep 12th 2002
From The Economist print edition

% change on year ago

	GDP 1 qtr*	GDP 1 year	The Economist poll GDP forecasts 2002	2003	Industrial production latest	Retail sales (volume) latest	Unemployment % rate latest	year ago
Australia	+ 2.4	+ 3.8 Q2	+ 4.0	+ 3.7	+ 4.3 Q1	+ 6.3 Q2	6.2 Aug	6.8
Austria	+ 0.3	– 0.6 Q1	+ 0.9	+ 2.4	+ 2.5 Jun	– 0.2 May	4.2 Jul	3.6
Belgium	+ 0.8	+ 0.3 Q2	+ 1.1	+ 2.7	– 4.1 Jun	– 4.2 Jun	12.0 Aug†	11.6
Britain	+ 2.4	+ 1.2 Q2	+ 1.7	+ 2.9	– 2.5 Jul	+ 4.5 Jul	5.2 Jul‡	5.1
Canada	+ 4.3	+ 3.2 Q2	+ 3.3	+ 3.4	+ 1.3 Jun	+ 6.3 Jun	7.5 Aug	7.3
Denmark	+ 4.4	+ 2.2 Q2	+ 1.6	+ 2.3	– 1.6 Jul	+ 4.1 Jun	5.1 Jul	5.1
France	+ 2.0	+ 1.0 Q2	+ 1.3	+ 2.6	nil Jun	– 2.5 Jun	9.0 Jul††	8.7
Germany	+ 1.1	+ 0.1 Q2	+ 0.6	+ 2.2	– 2.0 Jul	– 1.7 Jul	9.9 Aug§	9.3
Italy	+ 0.9	+ 0.2 Q2	+ 0.8	+ 2.4	– 5.4 Jun	– 0.8 Jun	9.0 Apr	9.5
Japan	+ 2.6	– 0.7 Q2	– 0.5	+ 1.0	+ 3.3 Jul	– 4.8 Jul	5.4 Jul	5.0
Netherlands	+ 0.5	+ 0.1 Q2	+ 0.9	+ 2.4	– 3.0 Jun	– 2.1 May	2.4 Jul**	2.0
Spain	+ 1.8	+ 2.0 Q2	+ 2.0	+ 2.9	+ 1.8 Jul	na	11.3 Jul	10.6
Sweden	+ 2.4	+ 2.1 Q2	+ 1.8	+ 2.7	– 1.3 Jun	+ 4.7 Jul	4.3 Jul†	4.2
Switzerland	+ 0.7	+ 0.2 Q1	+ 0.9	+ 2.2	– 8.8 Q1	+ 1.7 Jul	2.7 Aug†	1.7
United States	+ 1.1	+ 2.1 Q2	+ 2.5	+ 3.0	+ 0.2 Jul	+ 6.3 Jul	5.7 Aug	4.9
Euro area	+ 1.4	+ 0.6 Q2	+ 1.0	+ 2.4	– 1.2 Jun	– 0.9 Jun	8.3 Jul	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 8.8	+ 2.5 Q2	na	na	+ 5.1 Jul	+ 2.7 May	7.8 Jul†	7.6
Greece	na	+ 4.3 Q1	na	na	+ 1.9 Jul	+ 9.9 Apr	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.3 Jul†	1.1
Ireland	na	+ 2.9 Q1	na	na	+13.4 Jun	– 0.5 Jun	4.4 Aug	3.7
Luxembourg	na	+ 3.52001	na	na	+ 4.3 May	– 9.1 Apr	2.8 Jul†	2.4
New Zealand	+ 4.3	+ 4.0 Q1	na	na	+ 4.3 Q1	+ 8.3 Q2	5.1 Q2	5.3
Norway	+ 3.1	+ 1.7 Q2	na	na	+ 4.5 Jul	+ 2.9 Jun	3.8 Q2	3.6
Portugal	+ 1.4	+ 1.4 Q1	na	na	– 2.0 Jul	+ 0.9 Jul	4.5 Q2†	3.9

*% change at an annual rate. †Not seasonally adjusted. ‡May-July; claimant count rate 3.1% in Aug. §EU harmonised rate 8.3% in Aug. **May-Jul. ††Revised series.

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Prices and wages

Sep 12th 2002
From The Economist print edition

% change on year ago

	Consumer prices		The Economist poll consumer prices forecast		Producer prices		Wages/earnings	
	latest	year ago	2002	2003	latest	year ago	latest	year ago
Australia	+ 2.8 Q2	+ 6.0	+ 2.8	+ 2.5	– 1.1 Q2	+ 5.6	+ 3.7 Q2	+ 4.4
Austria	+ 1.6 Jul	+ 2.8	+ 1.7	+ 1.7	– 0.6 Aug	+ 1.7	+ 2.4 Jul	+ 2.8
Belgium	+ 1.3 Aug	+ 2.7	+ 1.7	+ 1.5	– 0.2 Jul	– 0.4	+ 2.6 Q2	+ 2.6
Britain	+ 1.5 Jul	+ 1.6	+ 1.9	+ 2.4	+ 0.3 Aug	+ 0.2	+ 4.0 Jul	+ 4.6
Canada	+ 2.1 Jul	+ 2.6	+ 1.8	+ 2.2	– 0.3 Jul	+ 0.8	+ 3.0 Jun	+ 1.5
Denmark	+ 2.3 Aug	+ 2.5	+ 2.3	+ 2.0	– 0.9 Jul	+ 2.7	+ 3.7 Q2	+ 4.7
France	+ 1.6 Jul	+ 2.1	+ 1.8	+ 1.4	– 1.5 Jun	+ 2.3	+ 3.8 Q2	+ 4.2
Germany	+ 1.0 Aug	+ 2.6	+ 1.4	+ 1.2	– 0.8 Jul	+ 2.2	+ 2.5 Jun	+ 1.9
Italy	+ 2.3 Aug	+ 2.8	+ 2.3	+ 1.8	+ 0.1 Jul	+ 1.3	+ 2.2 Jul	+ 2.5
Japan	– 0.8 Jul	– 0.8	– 0.9	– 0.5	– 1.3 Aug	nil	– 5.6 Jul	+ 0.7
Netherlands	+ 3.3 Aug	+ 4.7	+ 3.6	+ 2.4	– 0.4 Jul	+ 2.4	+ 3.0 Jul	+ 5.1
Spain	+ 3.4 Jul	+ 3.9	+ 3.3	+ 2.6	+ 0.6 Jul	+ 2.0	+ 4.0 Q1	+ 3.4
Sweden	+ 2.2 Jul	+ 2.9	+ 2.3	+ 2.0	– 0.8 Jul	+ 2.1	+ 2.9 Jun	+ 2.8
Switzerland	+ 0.5 Aug	+ 1.1	+ 1.0	+ 1.2	– 1.6 Jul	+ 0.2	+ 2.5 2001	+ 1.3
United States	+ 1.5 Jul	+ 2.7	+ 1.6	+ 2.2	– 1.1 Jul	+ 1.4	+ 3.1 Aug	+ 4.1
Euro area	+ 2.1 Aug	+ 2.7	+ 2.1	+ 1.6	– 0.6 Jul	+ 2.1	+ 3.3 Q1	+ 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.8 Jul	+ 2.6	na	na	– 1.3 Jul	+ 0.7	+ 3.8 Q2	+ 4.9
Greece	+ 3.5 Aug	+ 3.8	na	na	+ 0.7 Jul	+ 4.5	na	na
Iceland	+ 3.1 Sep	+ 8.4	na	na	+ 6.2 Aug	+ 6.9	+ 6.6 Jul	+ 8.1
Ireland	+ 4.2 Jul	+ 4.8	na	na	– 3.0 Jul	+ 4.5	+ 8.9 Q1	+ 7.4
Luxembourg	+ 2.0 Jul	+ 3.0	na	na	– 1.3 Jun	+ 0.1	+ 0.9 May	+ 2.7
New Zealand	+ 2.8 Q2	+ 3.2	na	na	+ 1.5 Q2	+ 8.1	+ 2.1 Q2	+ 1.8
Norway	+ 1.4 Aug	+ 2.7	na	na	– 8.6 Aug	– 4.3	+ 4.6 Q1	+ 4.4
Portugal	+ 3.4 Jul	+ 4.3	na	na	– 3.5 Jul	+ 1.3	– 0.2 Jun	– 0.6

Text refers only to the first 16 countries listed

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Money and interest rates

Sep 12th 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Sep 11th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 4.1	+ 9.4	Jul	4.91	4.42	5.01	5.58	5.45	6.58
Britain	+ 8.6	+ 5.7	Jul	3.94	4.75	3.93	4.56	4.83	5.77
Canada	+17.2	+ 7.2	Jul	2.82	3.55	3.39	4.97	5.20	6.79
Denmark	+ 6.2	+10.2	Jul	3.40	4.61	3.84	4.72	5.07	6.85
Japan	+31.5	+ 3.5	Aug	0.02	0.01	-0.02	1.04	1.39	1.15
Sweden	+ 2.2	+ 4.2	Jun	4.20	4.35	4.48	5.02	5.14	5.03
Switzerland	+10.9	+ 5.8	Jul	0.75	3.01	0.70	2.75	3.22	3.85
United States	+ 5.2	+ 7.4	Jul	1.73	3.24	2.19	4.06	4.73	6.32
Euro area†	+ 7.6	+ 7.1	Jul	3.32	4.18	3.39	4.47	4.76	5.35

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.88%, Japan No.241 1.05%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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Stockmarkets

Sep 12th 2002
From The Economist print edition

Market indices

	Sep 11th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	3,097.6	3,440.0	2,937.8	+ 1.6	-10.0	- 7.8	- 1.4
Austria (ATX)	1,131.9	1,357.2	1,109.5	+ 0.7	-34.8	- 0.7	+ 8.3
Belgium (Bel 20)	2,260.8	2,899.8	2,001.6	+ 4.8	-38.6	-18.7	-11.3
Britain (FTSE 100)	4,210.7	5,323.8	3,777.1	+ 4.6	-39.2	-19.3	-14.2
Canada (Toronto Composite)	6,618.3	7,958.1	6,161.1	+ 1.5	-41.9	-13.9	-12.8
Denmark (KBX)	187.0	233.4	169.0	+ 2.7	-38.0	-16.8	- 9.1
France (SBF 250)	2,272.1	3,081.9	2,067.7	+ 5.8	-48.3	-23.8	-16.8
(CAC 40)	3,397.0	4,688.0	3,023.7	+ 7.2	-50.9	-26.5	-19.8
Germany (Xetra DAX)	3,584.7	5,462.6	3,332.7	+ 4.6	-55.6	-30.5	-24.2
Italy (BCI)	1,173.2	1,513.0	1,077.8	+ 3.4	-46.2	-18.1	-10.7
Japan (Nikkei 225)	9,400.1	11,979.9	9,075.1	+ 3.6	-75.8	-10.8	- 3.1
(Topix)	917.1	1,139.4	886.4	+ 3.5	-68.2	-11.1	- 3.4
Netherlands (AEX)	367.4	531.2	318.5	+ 5.0	-47.6	-27.5	-20.9
Spain (Madrid SE)	675.0	848.1	625.9	+ 4.7	-41.1	-18.1	-10.6
Sweden (Affarsvarlden Gen)	154.0	236.8	143.1	+ 4.3	-61.5	-33.4	-25.8
Switzerland (Swiss Market)	5,250.9	6,694.1	4,607.8	+ 5.9	-37.6	-18.2	- 9.8
United States (DJIA)	8,581.2	10,635.3	7,702.3	+ 1.9	-26.8	-14.4	-14.4
(S&P 500)	909.5	1,172.5	797.7	+ 1.8	-40.5	-20.8	-20.8
(Nasdaq Comp)	1,315.5	2,059.4	1,206.0	+ 1.8	-73.9	-32.6	-32.6
Europe (FTSE Eurotop 300)*	958.3	1,279.7	862.3	+ 5.8	-43.8	-24.0	-17.0
Euro area (FTSE Ebloc 100)*	809.5	1,125.1	732.5	+ 6.6	-47.8	-27.2	-20.5
World (MSCI)†	821.6	1,024.4	756.7	+ 2.2	-43.3	na	-18.1
World bond market (Salomon)‡	493.8	504.2	430.3	- 1.7	- 2.1	na	+12.3

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Sep 12th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2002	2003	Exchange rate trade-weighted† Sep 11th	year ago	Currency units per $ Sep 11th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2002‡
Australia	− 1.3	Jul	− 11.6	Q2	− 3.7	− 3.8	73.4	71.3	1.83	1.93	2.83	1.78	1.52	0.1
Austria	− 2.0	May	− 1.3	Jun	− 2.2	− 1.9	na	100.3	1.03	1.10	1.59	–	0.85	-0.3
Belgium	+ 15.1	Jun	+ 11.8	Mar§	+ 5.0	+ 5.1	na	99.0	1.03	1.10	1.59	–	0.85	nil
Britain	− 44.9	Jul	− 31.2	Q1	− 2.1	− 1.9	106.6	106.6	0.65	0.68	–	0.63	0.54	-0.8
Canada	+ 34.0	Jun	+ 12.1	Q2	+ 2.1	+ 2.2	75.5	76.9	1.58	1.56	2.44	1.53	1.31	1.0
Denmark	+ 7.2	Jun	+ 3.5	Jun	+ 1.9	+ 1.8	102.8	102.6	7.64	8.22	11.8	7.42	6.34	2.2
France	+ 9.0	Jun	+ 28.4	Jun	+ 1.7	+ 1.6	na	101.7	1.03	1.10	1.59	–	0.85	-2.0
Germany	+104.5	Jul	+ 30.2	Jul	+ 1.2	+ 1.0	na	98.7	1.03	1.10	1.59	–	0.85	-2.8
Italy	+ 9.8	Jun	− 2.9	May	− 0.1	− 0.0	na	72.6	1.03	1.10	1.59	–	0.85	-1.4
Japan	+ 83.8	Jul	+110.9	Jul	+ 2.9	+ 2.9	134.9	140.4	121	119	187	117	–	-8.0
Netherlands	+ 23.7	Jun	+ 2.7	Q2	+ 3.9	+ 4.0	na	98.0	1.03	1.10	1.59	–	0.85	0.1
Spain	− 36.4	Jun	− 16.5	May	− 2.1	− 1.8	na	74.2	1.03	1.10	1.59	–	0.85	-0.3
Sweden	+ 14.7	Jul	+ 8.1	Jul	+ 3.2	+ 3.2	77.1	73.0	9.41	10.6	14.6	9.15	7.81	2.1
Switzerland	+ 3.0	Jul	+ 25.7	Q1	+10.0	+10.2	114.1	109.7	1.51	1.66	2.33	1.46	1.25	na
United States	−435.5	Jun	−398.1	Q1	− 4.5	− 4.1	114.4	117.5	–	–	1.55	0.97	0.83	-1.0
Euro area	+ 79.2	Jun	+ 24.8	Jun	+ 0.5	+ 0.5	81.1	78.9	1.03	1.10	1.59	–	0.85	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.6	Jun	+ 8.6	Jun	na	na	na	78.6	1.03	1.10	1.59	–	0.85	3.2
Greece	− 18.8	Mar	− 6.7	Mar	na	na	na	57.4	1.03	1.10	1.59	–	0.85	0.4
Iceland	+ 0.1	Jul	− 0.2	Q1	na	na	na	na	87.2	99.7	135	84.8	72.4	-0.5
Ireland	+ 33.5	Jun	− 0.4	Q1	na	na	na	87.4	1.03	1.10	1.59	–	0.85	0.1
Luxembourg	− 2.7	Jun	+ 1.7	Q1	na	na	na	99.0	1.03	1.10	1.59	–	0.85	2.2
New Zealand	+ 0.1	Jul	− 1.2	Q1	na	na	86.2	80.4	2.12	2.34	3.28	2.06	1.76	0.1
Norway	+ 24.9	Jul	+ 26.1	Jun	na	na	105.0	96.5	7.59	8.82	11.7	7.38	6.30	14.0
Portugal	− 12.6	Jun	− 9.5	Jun	na	na	na	89.4	1.03	1.10	1.59	–	0.85	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD forecast. §New series.

Text refers only to the first 16 countries listed

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The Economist commodity price index

Sep 12th 2002
From The Economist print edition

1995=100

	Sep 3rd	Sep 10th*	% change on one month	% change on one year
Dollar index				
All items	73.8	76.4	+ 4.0	+14.5
Food	78.3	81.9	+ 5.4	+20.8
Industrials				
All	67.7	68.8	+ 1.8	+ 5.7
Nfa†	70.5	70.9	– 0.2	+ 8.0
Metals	65.3	67.1	+ 3.7	+ 3.7
Sterling index				
All items	74.4	77.6	+ 2.6	+ 8.4
Euro index				
All items	97.4	103.1	+ 4.4	+ 6.7
Yen index				
All items	92.0	97.3	+ 4.5	+15.6
Gold				
$ per oz	313.95	318.20	+ 1.0	+10.3
West Texas Intermediate				
$ per barrel	27.77	29.64	+ 6.0	+ 7.3

* Provisional. † Non-food agriculturals.

commodity price index

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Stockmarkets

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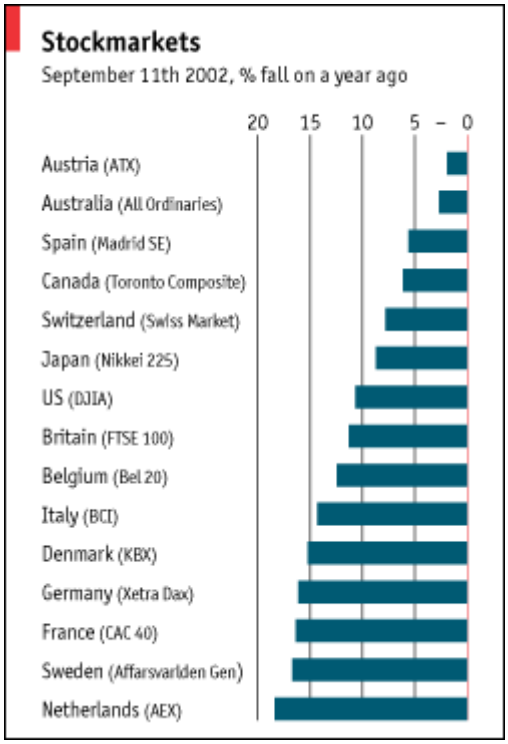

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Overview

Sep 12th 2002
From The Economist print edition

Industrial production rose sharply in several countries in the year to July. In the Czech Republic, it jumped by 10.8%, the biggest rise for 15 months. Output also rose by 12.3% in Turkey and by 7.8% in South Africa. The increase of 6.9% in Malaysia was the fastest for 18 months.

Stockmarkets in Russia and Eastern Europe regained ground. Moscow rose by 3.8% over the week, Warsaw by 4.3%. Asian stockmarkets were more unsettled. Manila rose by 3.5% and Bangkok by 2.7%, but Shanghai and Kuala Lumpur each fell by 2.6%.

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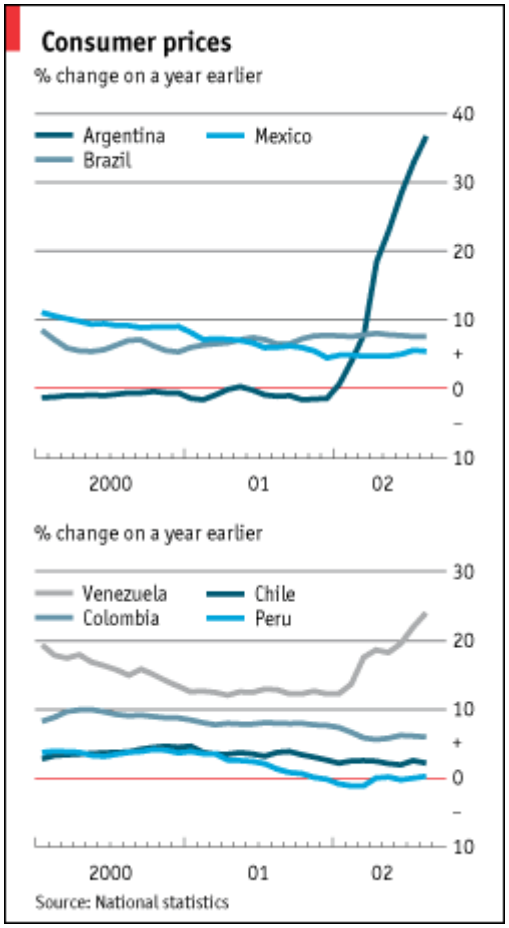
Consumer prices

Sep 12th 2002
From The Economist print edition

Argentina has a long history of battling against high inflation. But in the decade to December 2001 it succeeded in achieving price stability by pegging its peso to the dollar, backed by a strict currency-board regime. The recent financial crisis has, however, changed all that. Since Argentina abandoned its currency board in January the peso has fallen by 73%. As the chart shows, inflation has duly shot up. Consumer prices in August were 37% higher than a year ago. Venezuela has the second-highest inflation rate among Latin America's bigger economies. Consumer-price inflation there has doubled over the past year, to 24% in August. At the other extreme, Peru and Chile have inflation rates of only 0.3% and 2.2%, respectively.



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Economy

Sep 12th 2002
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.0	Q2	+12.7	Aug	– 0.9	Jul	+28.3	Jul	+17.4	2001	246.8	Jun
Hong Kong	+ 0.5	Q2	–11.6	Q1	– 3.4	Jul	– 8.2	Jul	+14.1	Q1	112.3	Aug
India	+ 6.4	Q1	+ 4.0	Jun	+ 3.9	Jul	– 5.1	Jul	+ 1.4	Q1	58.3	Aug
Indonesia	+ 3.5	Q2	– 9.4	Q4	+10.6	Aug	+27.3	Jul	+ 6.1	Q1	29.5	Jul
Malaysia	+ 3.8	Q2	+ 6.9	Jul	+ 2.1	Jul	+13.4	Jul	+ 7.0	Q1	32.8	Jul
Philippines	+ 4.5	Q2	+ 5.9	Jun	+ 2.9	Aug	+ 2.6	Jun	+ 6.2	May	13.4	Aug
Singapore	+ 3.9	Q2	+17.8	Jul	– 0.4	Jul	+ 6.4	Jul	+17.5	Q2	80.9	Aug
South Korea	+ 6.3	Q2	+ 8.9	Jul	+ 2.4	Aug	+ 9.8	Aug	+ 5.3	Jul	115.4	Jul
Taiwan	+ 3.0	Q2	+11.4	Jul	– 0.3	Aug	+18.6	Aug	+24.8	Q2	155.3	Jul
Thailand	+ 3.9	Q1	+ 9.6	Jul	+ 0.3	Aug	+ 3.8	Jul	+ 6.5	Jul	37.0	Jul
Argentina	–16.3	Q1	–11.2	Jul	+36.5	Aug	+13.4	Jul	nil	Q1	9.0	Jul
Brazil	+ 1.0	Q2	+ 3.3	Jul	+ 7.5	Aug	+ 7.4	Aug	–16.7	Jul	39.1	Jul
Chile	+ 1.7	Q2	+ 8.6	Jul	+ 2.2	Aug	+ 2.7	Jul	– 0.6	Q2	15.0	Jul
Colombia	+ 2.2	Q2	– 1.2	Jun	+ 6.0	Aug	+ 0.5	Jun	– 1.4	Q1	10.6	Jul
Mexico	+ 2.1	Q2	+ 1.9	Jul	+ 5.3	Aug	– 9.1	Jul	–16.3	Q2	46.1	Jul
Peru	+ 3.8	Jul	+ 6.8	Jul	+ 0.1	Aug	+ 0.2	Jun	– 1.0	Q2	9.2	Jul
Venezuela	– 9.9	Q2	–17.1	Jun	+24.0	Aug	+ 8.5	Q2	+ 1.9	Q2	7.6	Jun
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.7	Jun	– 8.2	Apr	– 0.1	Q1	12.6	May
Israel	– 1.7	Q2	+ 1.6	Jun	+ 6.9	Jul	– 6.3	Jul	– 2.3	Q1	24.5	Aug
South Africa	+ 2.2	Q2	+ 7.8	Jul	+10.6	Jul	+ 3.1	Jul	– 0.1	Q1	6.0	Jul
Turkey	+ 2.3	Q1	+12.3	Jul	+40.2	Aug	–10.3	Jun	+ 2.0	Jun	23.2	Jul
Czech Republic	+ 2.5	Q2	+10.8	Jul	+ 0.6	Aug	– 2.5	Jun	– 2.3	Q2	21.6	Aug
Hungary	+ 3.1	Q2	+ 5.1	Jul	+ 4.5	Aug	– 2.4	Jul	– 2.1	Jul	10.3	Jul
Poland	+ 0.5	Q1	+ 6.0	Jul	+ 1.3	Jul	–10.4	Jul	– 6.4	Jul	27.1	Jul
Russia	+ 3.7	Q1	+ 7.8	Jul	+15.2	Aug	+42.4	Jul	+28.3	Q2	40.6	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+21.3	Apr	+ 4.4	Jun	– 1.1	Aug	+ 0.3	2001†	4.8	Jun
Saudi Arabia	+ 1.2	2001	na		– 0.2	Apr	+44.1	2001	+14.5	2001	18.1	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Sep 12th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Sep 11th		Dec 31st 2001	
	Sep 11th	year ago	Sep 11th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.8	na	1,691.0	– 2.6	– 1.3	– 1.3
Hong Kong	7.80	7.80	12.1	1.77	9,882.4	+ 0.6	– 13.3	– 13.3
India	48.4	47.4	75.0	5.68	3,125.7	– 1.5	– 4.2	– 4.6
Indonesia	8,893	9,040	13,765	14.67	430.1	+ 2.3	+ 9.7	+ 28.3
Malaysia	3.80	3.80	5.88	3.20	689.7	– 2.6	– 0.9	– 0.9
Philippines	52.0	51.2	80.4	6.88	1,153.4	+ 3.5	– 1.3	– 2.0
Singapore	1.76	1.74	2.72	1.06	1,448.5	– 0.6	– 10.8	– 6.4
South Korea	1,205	1,285	1,865	4.80	724.7	+ 0.2	+ 4.5	+ 13.9
Taiwan	34.3	34.5	53.1	2.10	4,660.5	+ 2.8	– 16.0	– 14.4
Thailand	42.5	44.4	65.8	2.00	361.4	+ 2.7	+ 18.9	+ 23.8
Argentina	3.61	1.00	5.59	47.80	386.1	+ 3.3	+ 30.7	– 63.8
Brazil	3.10	2.67	4.80	17.89	10,182.2	+ 1.9	– 25.0	– 44.1
Chile	721	682	1,116	2.52	4,905.8	nil	– 9.1	– 16.7
Colombia	2,723	2,343	4,214	7.94	1,202.2	+ 0.9	+ 12.3	– 6.1
Mexico	9.97	9.46	15.4	6.87	6,260.6	+ 2.4	– 1.8	– 9.6
Peru	3.61	3.49	5.59	4.27	1,183.5	– 0.2	+ 0.7	– 4.0
Venezuela	1,492	746	2,309	20.00	7,195.5	+ 5.3	+ 9.5	– 44.4
Egypt	4.60	4.26	7.12	7.14	5,241.9	+ 0.2	– 0.6	– 1.1
Israel	4.75	4.32	7.35	6.40	362.7	+ 1.5	– 18.8	– 24.5
South Africa	10.6	8.62	16.4	12.65	9,941.5	+ 4.7	– 4.8	+ 7.5
Turkey	1,664,500	1,447,500	2,576,313	42.00	9,268.5	– 2.1	– 32.8	– 41.2
Czech Republic	30.6	37.7	47.4	3.02	453.7	+ 3.2	+ 15.0	+ 33.4
Hungary	250	284	387	9.70	7,631.2	+ 4.0	+ 7.0	+ 17.6
Poland	4.16	4.24	6.45	8.15	13,407.0	+ 4.3	– 3.7	– 8.6
Russia	31.7	29.5	49.0	21.00	346.9‡	+ 3.8	+ 38.5	+ 33.4
EMF (MSCI)*	1.00	1.00	1.55	na	297.6	+ 2.2	na	– 6.2
EMBI+†	1.00	1.00	1.55	na	208.2	+ 0.7	na	+ 3.9

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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